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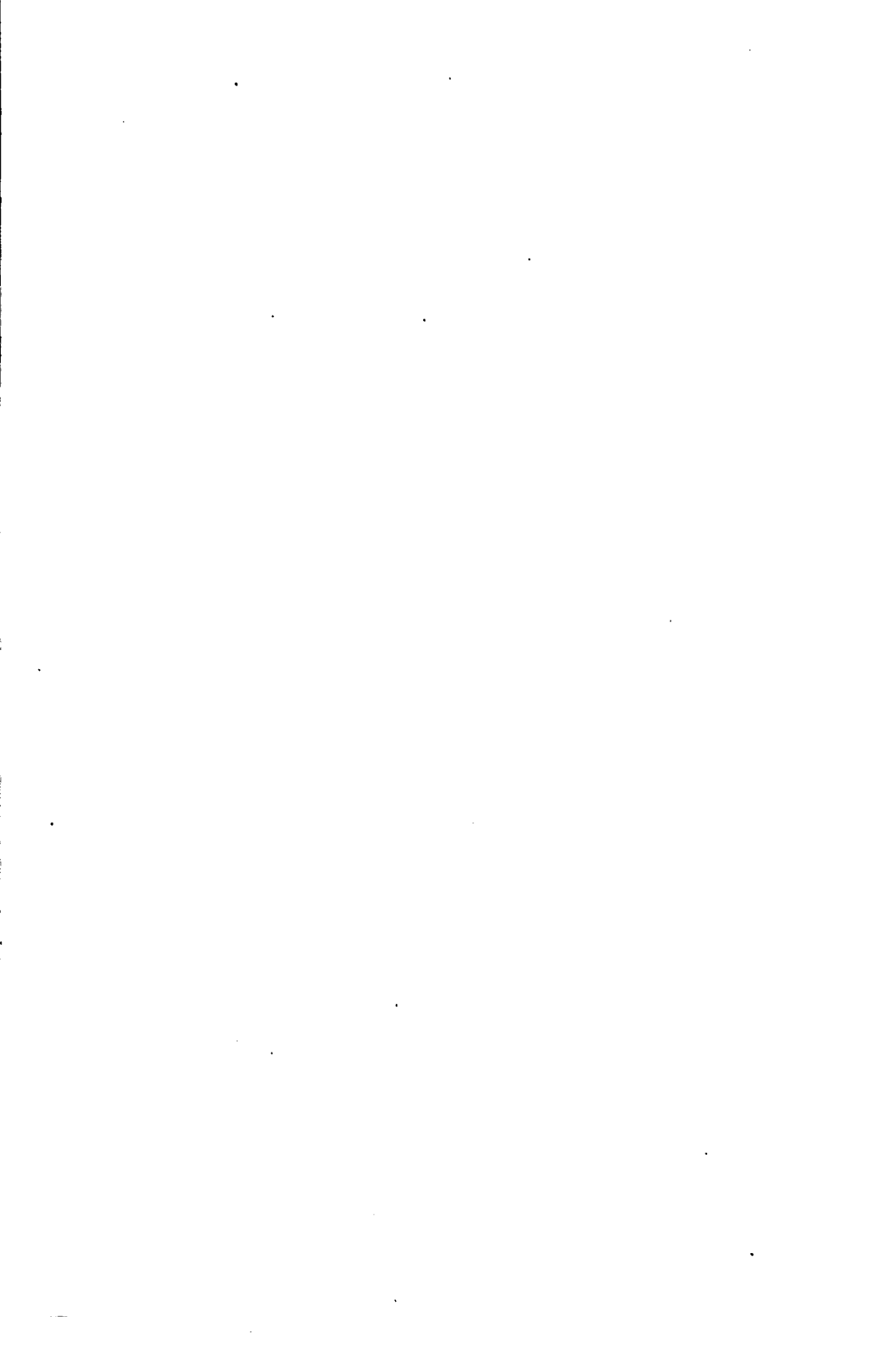


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LAW c 7
OF
CORPORATIONS

BY
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Dedication

To Manoh B. Reese.

Chief Justice Supreme Court of Nebraska.

**As a token of my high regard for your unselfish life,
as well as your eminent public services as Dean of the
Law School of the University of Nebraska, and Judge
of the Supreme Court of Nebraska.**

THIS WORK IS DEDICATED.



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THE LAW OF CORPORATIONS

CHAPTER I

INTRODUCTORY.

This work embraces a complete exposition of the law relating to the promotion, organization and management of private corporations, excepting *quasi*-public and insurance companies. The business institutions of this country are almost entirely controlled by corporations. The average business man has not kept pace with that development, for, while, as a rule, his business is under the management of a corporation, he has, generally speaking, neglected to inform himself on the method of corporate organization and management. The result is that, for the greater part, a man's business is managed by an agency, or entity, very little understood by him. Hence, the changed relationship existing between the law and business pursuits has created a strong demand for this particular effort. Within the last quarter of a century corporations have multiplied until, as stated, almost the entire mercantile and industrial business world has passed under their peculiar functions, and, in the same measure, corporations have come into force and effect in business affairs, until that great department of the law may be regarded as an element of business.

That progress has alike affected the lawyer and the business man. It has somewhat fused the legal and business practice together, and, as a result, the corporation lawyer finds it necessary to connect the two in-

terests in his work. One result in the changed conditions named is seen in the enormous volume of corporation litigation that has been developed within a few years. That circumstance greatly affects business interests generally. It is because of those conditions that there now is great need of a handy, carefully digested volume that will place before the lawyer, and within reach of the corporation promoter, director, officer, and stockholder, a properly classified treatise, with all necessary citations, forms, etc., covering every legal issue rising in the corporate affairs of the day.

After disposing of the various questions pertaining to the promotion of corporations, and the functions, qualifications and duties of the incorporators, attention is turned to the Articles of Incorporation. That instrument is fully and elaborately discussed, section by section, giving the law and necessary advice upon each and every part thereof; how it should be prepared; what it should contain; how executed and filed.

The interested person is then carefully piloted through the various and necessary steps to complete and perfect the organization of the corporation. The first, or organization meeting is, in this volume, practically held, and the necessary and proper things to be done and transacted are fully and carefully dealt with, including the paying of the capital stock of the corporation, accepting the charter, etc. Corporate stock of the various classes is taken up and dealt with in connection with such advice as is deemed proper and important. Preferred, common, guaranteed, full paid, watered, and overissued stock are all elaborated from every standpoint.

Care is taken to fully explain the method of paying up the capital stock, and the liabilities attached to stock when sold by the corporation for less than par, or exchanged for property at a fictitious valuation. The il-

legality of stock issued contrary to law is fully explained. Advice upon the question of where to incorporate is given after a detailed discussion of the advantages and disadvantages of the laws of the different states.

The rights, duties and liabilities of stockholders, directors, officers and promoters are fully and carefully discussed under separate sections. In connection with the question of management, an attempt has been made to fully explain the various knotty and bothersome questions that confront the officers and directors of the corporation in every day practice, and to give such instruction upon the same as is thought desirable. For the use of the corporation lawyer, as well as the promoter, this work contains what we believe to be a model corporation, giving every step from the articles of incorporation, to the annual meeting of the stockholders, including the calling and holding of the first, or organization meeting; the transferring of property to the corporation, paying up the capital stock, and issuing the same; accepting the charter, adopting the by-laws; electing directors and officers; calling and holding the annual meeting, and preparing the minutes and records thereof. Following that will be found a set of approval forms for the use of the corporation, or its directors and officers.

All cases cited have been selected with great care. In that department, which is exceptionally full, reference is made to the National Reporter system, American Decisions, American Reports, American State Reports, American & English Annotated Cases, and the Lawyers Reports Annotated.

The object steadily kept in view by the author in the preparation of these materials has been to include all necessary statutory provisions and court decisions touching promotion, organization and management in

a form not too bulky, and yet sufficiently comprehensive to supply all needed data. The volume herewith presented will be found, after a little use, to be a most convenient reference for the lawyer, the corporation promoter and business man.

Its contents are complete down to the present date; and its full directions, by forms and otherwise, are indispensable to the work of the corporation, proceedings incident thereto, and the general management of corporations in all their departments.

It is doubtful if the lawyer will find it necessary to go outside of this volume, except for a full digest of the decisions cited, in the preparation for trial in any case involving a corporation; and, in the general practice of corporation law he will find its contents almost indispensable.

Respectfully,

JOHN T. MULLIGAN.

CHAPTER II.

CORPORATIONS.

§ 1. Origin.

§ 2. Nature of.

§ 3. Creation.

§ 1. **Origin.**—Very little space will be devoted to a discussion of the origin and history of corporations. Whether they were introduced in Rome by Numo Pompilius, or devised by Solon, is of little or no concern to the average American promoter, or director, or officer of a corporation. Suffice it, therefore, to say, that for more than two thousand years corporate organizations have been recognized as a part of the industrial system of the world, and that during that period they have been changed, developed and remodeled to suit the changed conditions as they arose. The development of corporations in this country has been commensurate with industrial progress. It can be said, however, that the evolution of corporations as to a practical business system is confined almost entirely to the last century, the last half of which has witnessed their most remarkable growth.

During the last named period, public prejudice has given way sufficiently to fully demonstrate the practicability and stability of the system, and on every hand, we find nearly all the great industries of the land promoted, managed and controlled by corporations, with their thousands and hundreds of thousands of stockholders scattered throughout the country.

Generally speaking, three reasons may be assigned for the change from individual to corporate ownership. First, the necessity of some plan that would enable the

assemblage of large capital in the hands of a single entity; second, limited liabilities upon all members of such entity; and, third, perpetual succession. Of these three, we place the assemblage of capital first and foremost. There can be little doubt that the primary object of corporate organization today is that large capital may be concentrated in the hands of one management.

Large sums of money are necessary to develop the latent resources of the country. The giant industrial institutions require that millions of capital shall be assembled and concentrated under the control of a single entity in order to successfully develop and carry on great industrial undertakings. The corporate system furnishes the correct solution of this problem, as thousands and hundreds of thousands of persons contribute to the one fund to be managed and controlled by a single head.

Were it not for a system of this kind there can be no question that industries and industrial developments would yet be in their infancy. Therefore, were there no merit in the corporate system, save the means of concentrating capital, it would be worthy of adoption. Of course, the concentration of capital has been and always will be assailed. That feature should be carefully and scrupulously curbed so that the interests of all the people may properly be protected. While we place the assemblage and concentration of capital first and foremost, we are not unmindful of the fact that limited liability, that is, liability limited to the sum invested in the stock of the corporation, is one of the inducements that has led to the multiplicity of private corporations.

Formerly the latter was recognized as the all important consideration. In fact, it is regarded by many

able writers on corporation law as the primary object of incorporation. To us, however, it seems that this object is now secondary to the concentration of capital. The third and last important reason for corporate organization is by no means a small consideration. The death of a member, indeed, of all the members of a corporation does not necessarily affect the industry or business managed and controlled by it. Stockholders may die; directors may cease to be connected with the concern; officers may resign; yet the business of the concern may go on practically undisturbed, and the entity continue with new members, and new directors and officers, without a seriously disturbing halt or hitch. On every hand, especially in public service corporations, we witness the advantages of a system of this kind, which enables the business industries of the country to go forward continuously, without interruption.

§ 2. **Nature of.**—A corporation, as understood in the business world, is a collection of many individuals, united into one body, having perpetual succession under an artificial form, and vested by virtue of the law, under which it is organized, with capacity of acting in many respects as an individual. The members of the organization, commonly called stockholders, contribute to the one great fund which is called the capital of the corporation. That fund is managed and conserved by a special committee, selected by a majority of the stockholders, from among their number, and is called a board of directors or trustees. The trustees or directors, being the governing and controlling body of the corporation, naturally select such agents, or officers as are necessary to do the work required. The stockholders, as a safeguard to their interests, usually enact a set of rules and regulations prescribing the duties of the di-

rectors or trustees. These rules and regulations are called by-laws.

The corporation is, of course, a separate and distinct entity, as such, and has powers, rights and duties of its own, which powers, rights and privileges do not in any sense belong to the individual members or stockholders thereof.¹ That is so, notwithstanding the fact that one person owns all of the capital stock of the corporation. The fact that one person owns all of the stock of the corporation, does not cause the corporation to lose its identity, nor does it in any way deprive the corporation, as an entity, of its rights, powers, and privileges.² This legal fiction, however, may be disregarded in the interest of justice.³ It necessarily

¹ *Hearst v. Putnam Mining Co.*, 28 Utah, 184, 77 Pac. 753, 107 Am. St. Rep. 698; *Wells v. Dane*, 101 Me. 67, 63 Atl. 324; *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 93 N. W. 1024, 108 Am. St. Rep. 716; *Oudin, etc. Co. v. Conlan*, 34 Wash. 216, 75 Pac. 802; *In re Owens' Est.*, 30 Utah, 351, 85 Pac. 277; *Commonwealth v. Monongahela Bridge Co.*, 216 Pa. 108, 64 Atl. 909; *State v. Tacoma Ry., etc. Co.*, 61 Wash. 507, 112 Pac. 506.

² *Commonwealth v. Monongahela Bridge Co.*, 216 Pa. 108, 64 Atl. 909; *Monongahela Bridge Co. v. Pittsburgh, etc. Co.*, 196 Pa. St. 25, 46 Atl. 99; *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, 21 S. W. 531, 42 Am. St. Rep. 335; *Exchange Bank v. Macon Const. Co.*, 97 Ga. 1, 25 S. E. 326, 33 L. R. A. 800.

³ *In re Watertown Paper Co.*, 169 Fed. 252; *First Nat. Bank, etc. v. Trebein Co.*, 59 Ohio St. 316, 52 N. E. 834; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 78 Am. St. Rep. 707; *In re Rieger, Kapner & Altmark*, 157 Fed. 609; *South. Florida, etc. Co. v. Waldin*, 55 South. 862.

The Supreme Court of Ohio, in *Cincinnati, etc. Co. v. Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033, 48 L. R. A. 732, 78 Am. St. Rep. 707, says, "The idea that the corporation is an entity distinct from the incorporators who compose it has been aptly characterized as 'a nebulous fiction of thought.' Much learning has been indulged in and much space occupied by text-writers and others in an effort to differentiate the essential character of a corporation from that of its stockholders and great ingenuity has been displayed in the argument, but it has been in the main a fruitless metaphysical discussion.

follows, therefore, that the acts of the stockholders or members of the corporation are not the acts of the corporation itself and *vice versa*.

A corporation differs from a joint stock company in that a joint stock company partakes of the properties of a general commercial partnership, notwithstanding such organizations possess a common capital divided into a certain number of shares, which shares are owned by its members.

All corporations are created by law, while a joint stock company is brought into existence by the contract of its members. Again, the law imposes upon the members of a joint stock company greater and different personal liabilities than is imposed upon the members or stockholders of a corporation.⁴

For certain purposes, a corporation will be considered, in law, as a "resident" or "inhabitant" of some particular state.⁵ So, too, a corporation is an "asso-

For the purpose of description, and defining corporate rights and obligations, and characterizing corporate action, the fiction that the corporation is an artificial person or entity, apart from its members, may be convenient and possibly useful, but in the opinion of the writer the argument favoring the essential separate entity of the corporation fails, and it is believed that the effort has resulted in misleading conceptions and in much confusion of thought upon the subject. When all has been said it remains that a corporation is not in reality a person or a thing distinct from its constituent parts, and the constituent parts are the stockholders, as much so in essence and in reality as the several partners are the constituent parts of the partnership. Stripped of misleading verbiage, the corporation is a device created by law whereby an aggregation of persons who may avail themselves of its privileges by organization are permitted to use their property in a way different from that which is permitted to others who do not so organize, and with certain special advantages, among which are a measure as to personal liability for debts and the power to perpetuate the organization denied by the law to all others."

⁴ *Spotswood v. Morris*, 12 Idaho, 360, 85 Pac. 1094; *People v. Rose*, 219 Ill. 46, 76 N. E. 42.

⁵ *Hastings v. Anacortes Pack Co.*, 29 Wash. 224, 69 Pac. 776; *Squire & Co. v. Portland (Me.)*, 76 Atl. 679; *Cunningham v. Klamath*,

ciation" under the United States revised statutes, giving the right to enter and purchase coal mines.⁶ The law now is well settled that a mining corporation can locate and patent mining claims.⁷ Corporations are persons within the meaning of the constitutional provisions, forbidding the deprivation of property without due process of law, as well as, forbidding a denial of the equal protection of the law.⁸

A corporation, however, is not a citizen within the meaning of the 14th amendment to the Constitution of the United States, and is not entitled to the privileges and immunities granted citizens by that constitutional provision.⁹

§ 3. Creation.—The power to create corporations is vested in the legislative branch of the government. Hence, it is well settled that legislative authority is a prerequisite to legal incorporation. That is to say, the first requisite to corporate existence is a law authorizing the organization of the corporation for the

etc. Co. (Ore.), 101 Pac. 1099; *Mahopoulus v. Chicago, etc. Co.*, 167 Fed. 165; *O'Brien v. Big Casino Gold, etc. Co.*, 9 Cal. App. 283, 99 Pac. 209.

⁶ *U. S. v. Trinidad Coal Ming. Co.*, 137 U. S. 16, 34 L. Ed. 640.

⁷ *Dahl v. Montana Copper Co.*, 132 U. S. 264, 33 L. Ed. 325; *McKinley v. Wheeler*, 130 U. S. 630, 32 L. Ed. 1048; *Thomas v. Chisholm*, 13 Colo. 105, 21 Pac. 1019; *Princeton v. Bank*, 7 Mont. 530; *Book v. Justice Mining Co.*, 58 Fed. 106.

⁸ *Northern Securities Co. v. U. S.*, 193 U. S. 197; *Covington, etc. R. Co. v. Sandford*, 164 U. S. 578, 17 Sup. Ct. Rep. 198, 41 L. Ed. 560; *Pembina Con. M. & M. Co. v. Penn.*, 125 U. S. 181, 8 Sup. Ct. Rep. 737, 31 L. Ed. 650; *Santa Clara Co. v. South. Pac. R. Co.*, 118 U. S. 394, 6 Sup. Ct. Rep. 1132, 30 L. Ed. 118; *Kiley v. Chicago, etc. Co.*, 138 Wis. 215, 119 N. W. 309; *Birmingham Water Works Co. v. State (Ala.)*, 48 South. 658; *South. Ry. Co. v. Greene*, 216 U. S. 400.

⁹ *Western Turf Assn. v. Greenberg*, 204 U. S. 359.

¹⁰ *Clark v. Am. Cannel Coal Co.*, 165 Ind. 213, 73 N. E. 1083, 112 Am. St. Rep. 217; *Davis v. Stevens*, 104 Fed. 235; *Huber v. Martin*, 127 Wis. 412, 105 N. W. 1031, 115 Am. St. Rep. 1023; *Am. L. & T.*

purposes contemplated and sought to be carried out.¹⁰ The second requisite is a substantial compliance with the provisions of such law.¹¹ The third and last requisite is the acceptance of the corporate charter and user of its franchise.¹² The legislative power to create corporations is of course subject to the constitutional restrictions and limitations of the several states.

A few Courts assert that a corporation, that is a *de facto* corporation, may be organized and exist under an unconstitutional law.¹³ The undisputed weight of authority, however, holds that a corporation can neither legally be organized nor exist if the law under which the attempt to organize is made is unconstitutional.¹⁴ In all of the states except Connecticut, Rhode

Co. v. Minn., etc. Co., 157 Ill. 641, 42 N. E. 153; State v. Stevens, 16 S. D. 309, 92 N. W. 429; Marshall v. Keach, 227 Ill. 35, 81 N. E. 29, 118 Am. St. Rep. 247; Hossack v. Ottawa Dev. Ass'n, 244 Ill. 274, 91 N. E. 439.

¹¹ Jones v. Aspen Hdwe. Co., 21 Colo. 263, 40 Pac. 457, 52 Am. St. Rep. 220, 29 L. R. A. 143; Johnson v. Okerstrom, 70 Minn. 303, 73 N. W. 147; Allen v. Long, 80 Tex. 261, 16 S. W. 43, 26 Am. St. Rep. 735; Taylor v. Branham, 35 Fla. 297, 48 Am. St. Rep. 249; Garnett v. Richardson, 35 Ark. 144; Abbott v. Omaha, etc. Smelt. Co., 4 Neb. 416; Bergeron v. Hobbs, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85; Walton v. Oliver, 49 Kan. 107, 30 Pac. 172, 33 Am. St. Rep. 355.

¹² Stout v. Zulick, 48 N. J. L. 599, 7 Atl. 362; Mitchell v. Jensen, 29 Utah, 346, 81 Pac. 165; Harris v. Gateway Land Co., 128 Ala. 652, 29 South. 611; Tulare Irr. Dist. v. Sheppard, 185 U. S. 1, 46 L. Ed. 773; Clark v. Am. Cannel Coal Co., 165 Ind. 213, 73 N. E. 1083, 112 Am. St. Rep. 217; Kwapił v. Bell Tower Co., 55 Wash. 583, 104 Pac. 824.

¹³ Richards v. Minn. Savings Bank, 75 Minn. 196, 77 N. W. 822; Coxe v. State, 144 N. Y. 396, 39 N. E. 400.

¹⁴ Clark v. Am. Cannel Coal Co., 165 Ind. 213, 73 N. E. 1083, 112 Am. St. Rep. 217; Huber v. Martin, 127 Wis. 412, 105 N. W. 1031, 115 Am. St. Rep. 1023; McTighe v. Macon Const. Co., 94 Ga. 306, 21 S. E. 701, 47 Am. St. Rep. 153, 32 L. R. A. 208; Norton v. Shelby Co., 118 U. S. 425, 30 L. Ed. 178; Guthrie v. Territory, 1 Okl. 188; Burton v. Schieldach, 45 Mich. 504; Marshall v. Keach, 227 Ill. 35, 81 N. E. 29, 118 Am. St. Rep. 247.

Island, South Carolina and Vermont, constitutional provisions have been enacted forbidding incorporation of corporations by special act. Hence, all corporations to be organized under the laws of any of the states, except those above enumerated, must be organized under the general incorporation acts.

The laws of the several states differ more or less in many respects as to the requirements of legal incorporation, so that it always will be necessary to consult the statutes of the state wherein incorporation is sought. However, the organization of corporations under the general business corporation acts of the several states is now very simple and easily carried out.

The idea of the organization and creation of a corporation to promote a certain business or enterprise, such as developing mines, or carrying on some industrial scheme, or plan, is usually born in the mind of a promoter who desires to float the enterprise or undertaking. Usually the promoter will lack the necessary or required capital to successfully carry out the scheme or plan. Hence, after having developed the idea, and the plan of its execution, his first step will be to choose associates as best suits the plan or undertaking, to assist in the organization and incorporation of the company.

After his associates have been chosen, and the plan of operation fully developed, the necessary legal requirements of the proposed company will be agreed upon, which data, in turn will be placed in the hands of an attorney selected to prepare the articles of incorporation. It always should be remembered in creating corporations, that the purposes for which the corporation is created must be within the purview of the statutes under which the organization, or incorporation is sought, and must be for some legal object and purpose.

The state may limit the duration of corporations and may also provide conditions precedent to their existence.¹⁵

¹⁵ *City of New York v. Bryan*, 130 App. Div. 658, 115 N. Y. S. 551.

CHAPTER III.

PROMOTER.

- § 4. Definition.
- 5. Functions.
- 6. What is necessary to constitute one a promoter.
- 7. When his relation as promoter ceases.
- 8. His relation to the corporation.
- 9. Duties.
- 10. Corporation purchasing property from promoter.
- 11. Promoters' contracts entered into prior to incorporation.
- 12. Promoters' personal liabilities for contracts made in the corporate name prior to incorporation.
- 13. Compensation.
- 14. Liability of the corporation for promoters' contracts entered into prior to incorporation.
- 15. Promoters' frauds.
- 16. Remedy of the corporation.

§ 4. **Definition.**—The word “Promoter” had its origin in the method by which joint stock companies were formed in England, where, by the law, they were declared partnerships. Subsequently, when the era of railroad building began in that country, the business of promoting the organization of such companies assumed definite form.¹

“A promoter,” says the Supreme Court of Virginia, “is a person who brings about the incorporation and organization of a corporation. He brings together the persons who become interested in the enterprise, aids in procuring subscriptions, and sets in motion the machinery which leads to the formation of the corporation itself.”²

“The term, promoter, involves the idea of exertion

¹ *St. Louis, etc. Ry. Co. v. Tiernan*, 37 Kan. 606, 15 Pac. 544.

² *Bosher v. Richmond, etc. Co.*, 89 Va. 455, 16 S. E. 360; see also *Richlands Oil Co. v. Morris*, 108 Va. 288, 61 S. E. 762; *Pittsburg Mining Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149; *Bige-*

for the purpose of getting up and starting a company, and also the idea of some duty toward the company, imposed by, or arising from the position, which the so-called promoter assumes toward it."³

§ 5. **Functions.**—Generally speaking, the modern promoter covers a much broader field in his operations than is indicated by the above definitions. Indeed, it can truthfully be said that he not only, "Sets in motion the machinery that leads to the formation of the company," but he, "moulds its form and shapes its destiny." He conceives an idea and develops it into a working plan, to be carried out by a corporation. He brings the corporation into existence and evolves through it, by such plan, an enterprise or business, often gigantic in its proportions. He selects the incorporators, and usually, the first board of directors. Often he owns the very property that will afterwards be acquired by the corporation, but more often, and, in most cases, he simply holds an option on such property, which will be turned over to the corporation at a large price after the organization is completed. One thing is settled beyond debate or conjecture, and that is, that the modern, up-to-date promoter promotes a corpora-

low v. Old Dom. Copper Co. (N. J. Eq.), 71 Atl. 153; Arnold v. Searling (N. J.), 78 Atl. 762; Dickerman v. Northern Trust Co., 176 U. S. 181, 44 L. Ed. 423; Ex-Mission Land Co. v. Flash, 979 Cal. 610, 32 Pac. 600; Mason v. Carrother, 105 Me. 392, 74 Atl. 1030; Armstrong v. Sun, etc. Assn., 137 App. Div. 828, 122 N. Y. S. 531; Old Dom. Copper, etc. Co. v. Bigelow, 203 Mass. 159, 89 N. E. 193; Anderson's Dictionary of Law, 834

* Emma Silver Ming. Co. v. Lewis, L. R. 4 C. P. D. 396, 407. See also Hinckley v. Oil & Pipe Line Co., 132 Iowa, 396, 107 N. W. 629, 119 Am. St. Rep. 564; Telegraph v. Loetscher, 127 Iowa, 383, 101 N. W. 773, 4 A. & E. Ann. Cas. 667; See v. Heppenheimer, 69 N. J. Eq. 36, 61 Atl. 854; Arnold et al. v. Searling et al., 78 Atl. (N. J. Eq.) 762; McMullen v. Ritchie, 64 Fed. 253; Yale Gas Stove Co. v. Wilcox, 64 Conn. 101, 29 Atl. 303, 42 Am. St. Rep. 159, 25 L. R. A. 90.

tion, or an enterprise, not for insignificant promotion fees, but for the special profits derived from such incorporation, and an interest in the corporation, after the same is organized, which interest he usually secures by a series of manipulations, using the incorporators and the first board of directors as "dummies." That the modern promoter has fallen into disrepute in certain localities is not to be wondered at, yet, after all, he is an indispensable part of corporate organizations, if not an indispensable part of the great industrial system of the United States. We offer no excuse or defense for the unscrupulous and dishonest promoter. However, we do say, that the average promoter is well meaning and honest of intention, but that, often, he is led away by his colossal dreams and optimistic visions, natural to his make-up. There is no overlooking the fact, that the foundations of countless great and growing industries have been laid by the promoter; and an endless number of gigantic enterprises for the good of the general public have been developed and carried to a successful issue by him.

His dreams in countless instances have been developed into realities. The great productiveness of the endless undeveloped resources of the commonwealth are such that promoters' profits can be made, and at the same time, the enterprise return handsome dividends on the investment, if the promotion is conducted in a fair, open, honest manner. Hence, the operations of the promoter, confined to fair, honest dealing, giving, also, a reasonable latitude to him in his transactions, always will be welcomed and encouraged in this country.

There is no denying the fact that the interested and influential members of a corporation which becomes a failure are always ready and willing to find a scape-goat upon whom to shift the burden of responsibility

for failure, and that scapegoat nearly always is the promoter.

The law always has held the promoter, by reason of his position, to a high degree of accountability. The term, "promoter," often has been characterized as a name, not of law, but of business.⁴ While it is true that the term, "promoter," involves the idea of devising a scheme and developing it into a working plan; the bringing together of the interested parties; the getting up, organizing, and starting of the corporation; and, very often, financing and floating it; yet there enters into all those steps, duties, rights and liabilities of such a nature, that it is easy to see that the appellation, "promoter," has come to be, not only a business one, but one of law as well. By assuming the position that he does, and the doing of the acts in becoming a promoter of the corporation, he puts himself in a peculiar relation, as a matter of law, not only to the corporation, when its existence is completed, but to its future stockholders.

That is a relation that has been, from time immemorial, held by the courts to be one of such a nature as required at all times the utmost good faith and fair dealing toward such corporation and its stockholders.

§ 6. What is necessary to constitute one a promoter. Much difficulty has been experienced by the courts in determining who is, and who is not a promoter and when his relations as such begin and when they end. A test often applied by the courts is the establishment of the fiduciary relation,⁵ but this seems only to be traveling in a circle. To begin with, the question whether a person is or is not a promoter is a question

⁴ *Whaley Bridge Calico Printg. Co. v. Green*, L. R. 5 Q. B. D. 111; *Emma Silver Co. v. Lewis*, L. R. 4 C. P. D. 396, 407.

⁵ *In re Ambrose Lake Tin, etc. Ming. Co.*, 14 Ch. D. 398.

of fact.⁶ Being a question of fact, the facts of each particular case must be looked into, in order to determine the matter.

In the first place, something must be done by a person to impose upon him this term in connection with the plan of bringing into existence the corporation; that is, some steps must be taken by him, or his agent, directly or indirectly, looking to the floatation or formation of the corporation.⁷ Such acts as framing a scheme; preparing or causing a prospectus to be printed and circulated; advertising, or paying for the same; bringing the enterprise to the attention of the general investing public, and paying the expenses therefor; using his influence to induce others to take stock; actively promoting its organization; advising and participating in the purchase of the property for which the company is organized; having the articles of incorporation prepared, and procuring the formation of the corporation and arranging for the financing of the project are all acts tending to establish the relation, and to constitute one a promoter.⁸

The courts will no doubt, in all cases, look carefully to the substance of the transactions for the purpose of determining whether or not a person is a promoter, and, "No doubt a very little will make people promoters of a company, if it can be seen that they are really doing something for their own interests, and are not acting merely as agents of others."⁹ The most

⁶ *Emma Silver Ming. Co. v. Lewis*, L. R. 4 C. P. D. 396; *Ladywell Ming. Co. v. Brookes*, L. R. 35 Ch. D. 400; *S. Mo. Pine Lumber Co. v. Crommer*, 202 Mo. 504, 101 S. W. 22.

⁷ *Alger on Promoters and Promotion of Corporations*, § 16; 2 *Lindley on Partnership*, 585.

⁸ *Twycross v. Grant*, L. R. 2 C. P. D. 469; *Jordan & Browne on Joint Stock Companies*, 62; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; *Telegraph v. Loetscher*, 127 Ia. 383, 101 N. W. 773, 4 A. & E. Ann. Cas. 667.

⁹ *Lydney & Wigpool Iron Ore Co. v. Bird*, L. R. 33 Ch. D. 85.

pertinent inquiries are, "Who undertook the liability for the expenses of the preliminaries of incorporation?" and "Who will be benefited by the company?" It is believed that with one exception these two questions are decisive and conclusive of the question now under consideration. That exception is, of course, where one is acting merely as the agent for others. However, in this regard, it is to be noted that the fact that one is an agent will not be decisive or conclusive against his being a promoter also.

Thus, where the owners of certain mines employed an agent to incorporate a corporation for the purpose of purchasing the mines from his principal, which he afterwards did, and in the transaction was paid large commissions for his services, the courts held, that while he was the agent for the vendors, who organized the corporation, he also was the promoter of the corporation, and held him liable as such;¹⁰ and it has been held that the fact that the agent gets no compensation or commission from the corporation, but is compensated by his principal, is not decisive against his being the promoter of the corporation, as well as the agent of the parties employing him to organize the corporation.¹¹

On the other hand, it has been held that mere intention to incorporate a corporation, does not, *ipso facto*, constitute one a promoter, nor does the agreement to promote a corporation, *ipso facto*, constitute one a promoter.¹² It has been held that purchasing property contemplating to transfer such property to a corporation afterwards to be formed, does not constitute one a promoter, even though the company was actually

¹⁰ *Lydney & Wigpool Iron Co. v. Bird*, L. R. 33 Ch. D. 85; *South Joplin Min. Co. v. Case*, 104 Mo. 572.

¹¹ *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218.

¹² *Alger on Promoters and Promotion*, § 16; *Highway Advertising Co. v. Ellis*, 7 Ont. L. Rep. 504.

formed;¹³ and that the acquiring of an option on property with intent to afterward sell the property to a corporation when the same is to be formed, does not, *ipso facto*, constitute one a promoter.¹⁴ For additional cases upon this question see cases cited in the note.¹⁵

§ 7. **When his relation as promoter ceases.**—Generally speaking, the functions, duties and liabilities of a promoter cease upon the completion of the organization of the corporation. However, this is not necessarily so, and where a person continues to promote the affairs of the corporation after its incorporation has been completed, his relationship continues, and he is under the same obligations and liabilities as before the corporation was brought into existence.¹⁶

§ 8. **His relation to the corporation.**—The law is now well settled, both in this country and in England, that a promoter occupies a fiduciary relation to the corporation, whose organization he has promoted, and to its future stockholders.¹⁷ As such, he is under a high de-

¹³ *Ladywell Ming. Co. v. Brookes*, L. R. 35 Ch. D. 400; *Old Dominion Copper, etc. Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479.

¹⁴ *Gover's Case*, 1 Ch. D. 182.

¹⁵ *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 44 L. Ed. 423; *See v. Heppenheimer*, 69 N. J. Eq. 36, 61 Atl. 854; *Chandler v. Bacon*, 30 Fed. 538; *Pittsburg Ming. Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149; *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 29 Atl. 303, 42 Am. St. Rep. 159, 25 L. R. A. 90; *Burbank v. Dennis*, 101 Cal. 90, 35 Pac. 444; *Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 107 Am. St. Rep. 1017; *Old Dominion Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; *Hinckley v. Oil & Pipe Line Co.*, 132 Ia. 396, 107 N. W. 629, 119 Am. St. Rep. 564; *Arnold v. Searing* (N. J.), 78 Atl. 762; *Travis v. Travis*, 124 N. Y. S. 1021.

¹⁶ *Russell v. Rock Run Fuel Gas Co.*, 184 Pa. St. 102, 39 Atl. 21; *Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 107 Am. St. Rep. 1017; *Emma Silver Ming. Co. v. Lewis*, 4 C. P. D. 396.

¹⁷ *Hinckley v. Oil & Pipe Co.*, 132 Ia. 396, 107 N. W. 629, 119

gree of accountability, by reason of the fact that the corporation is wholly helpless to care for itself. The promoter brings the corporation into existence and constitutes himself its trustee without a wish exercised on the part of the corporation, which is at all times wholly helpless in his hands.

The often cited rule of Lord Cairns,¹⁸ is now believed to be the settled law of the United States, to-wit: "They stand, in my opinion, undoubtedly in a fiduciary capacity. They have in their hands the creation and moulding of the company; they have the power to define how and when and in what shape, and under what supervision, it shall start into existence and begin to act as a trading corporation." The Supreme Court of the United States,¹⁹ says, "The promoter is the agent of the corporation and subject to the disabilities of an ordinary agent. His acts are scrutinized carefully, and he is precluded from taking a secret advantage of the other stockholders." This relation once established, it follows, as a matter of law, that such a person is required, in the exercise of his duties and

Am. St. Rep. 564; *Telegraph v. Loetscher*, 127 Ia. 383, 101 N. W. 773, 4 A. & E. Ann. Cas. 667; *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 523; *Old Dominion Copper Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; *Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 107 Am. St. Rep. 1018, 68 L. R. A. 951; *Tropical Fruit Co. v. Buck*, 52 N. J. Eq. 219; *Pittsburg Ming. Co. v. Spooner*, 74 Wis. 307, 17 Am. St. Rep. 149; *See v. Heppenheimer*, 69 N. J. Eq. 36, 61 Atl. 854; *Scott v. Farmers' & Merchants' Natl. Bank*, 97 Tex. 31, 75 S. W. 7, 104 Am. St. Rep. 835; *Erlanger v. New Sombrero Phos. Co.*, 3 App. Cas. 1236; *In re Lady Forrest Gold Ming. Co.*, 1 Ch. 582; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; *Wills v. Nehalem Coal Co.*, 52 Ore. 70, 96 Pac. 534; *Mason v. Carrothers*, 105 Me. 392, 74 Atl. 1030; *Arnold v. Searing* (N. J. Eq.), 78 Atl. 762; *Jordan v. Annex Corporation*, 109 Va. 625; *Torrey v. Toledo, etc. Co.*, 158 Mich. 348, 122 N. W. 614; *Johnson v. Sheridan Lumber Co.*, 51 Ore. 35, 93 Pac. 470; *Mangold v. Adrian Irr. Co.*, 60 Wash. 286, 111 Pac. 173.

¹⁸ *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218.

¹⁹ *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 44 L. Ed. 423.

functions, to use the utmost good faith, the most complete truthfulness, and a careful regard for the protection of the future stockholders. "The power to nominate a directorate is manifestly capable of great abuse, and may involve in the use of it, very evil consequences to a multitude of people, who have little capacity to guard themselves. Such power may or may not have been wisely permitted to exist. I venture to have doubt upon the point. It tends too much to fraudulent contrivances, and mischievous deceptions; and, at least, it should be watched with jealousy and restrained from employment in such a way as not to mislead the ignorant and the unwary. In all such cases, the directorate nominated by the promoters, should stand between them and the public with such independence and intelligence, that they may be expected to deal fairly, impartially, and with adequate knowledge, in the affairs submitted to their control. If they have not those qualities, they are unworthy of the trust. They are the betrayers, and not the guardians of the company they govern, and their acts should not receive the sanction of a court of justice."²⁰

§ 9. **Duties.**—His relation as promoter having been established, it follows, as a matter of law, that he will be precluded from taking any secret profit in any of his transactions with the corporation, or any advantage of the stockholders in any way. In other words, the old and familiar rule that, "All persons, who stand in a fiduciary relation to others must account for all the profits," made by reason of such relation, or made in any way out of the trust property, unless, of course,

²⁰ *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1218; see also *Hinckley v. Oil & Pipe Line Co.*, 132 Iowa, 396, 107 N. W. 629, 119 Am. St. Rep. 564; *Telegraph v. Loetscher*, 127 Iowa, 383, 101 N. W. 773, 4 A. & E. Ann. Cas. 667; *Goodwin v. Wilbur*, 104 Ill. App. 45.

made with the knowledge and consent of the *cestui que trust*, applies with equal force to promoters; and where a corporation is promoted, organized, and brought into existence for the purpose of purchasing property or options, owned by its promoter, or property in which he has an interest of any kind, or where he attempts, or where an attempt is made, to make or enter into any kind of a contract in which he has a personal interest or profit, it is incumbent upon him to see to it that in forming the corporation, he provide it with a board of directors, who shall be aware that he is interested in the transaction, and who shall be competent, impartial and independent judges as to whether the contract or transaction should be entered into. - That is to say, his first duty to the corporation and its stockholders, requires that he provide the corporation with a competent, independent and capable board of directors, with such independence and intelligence that they may be expected to deal fairly, impartially and with adequate knowledge; and his second duty is to make a full, fair and complete disclosure of his interest in the contract, and the transaction, to the board of directors.²¹

In the often cited Erlanger case, the Lord Chancellor said, "If they are doing all this in order that the company may, as soon as it starts into life, become, through its managing directors, the purchasers of the property of themselves, the promoters, it is in my opinion, incumbent upon the promoter to take care, that, in forming the company, they provide it with an executive, that is to say, with a board of directors, who shall be both

²¹ *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 44 L. Ed. 423; *See v. Heppenheimer*, 69 N. J. Eq. 36, 61 Atl. 854; *Erlanger v. New Sombrero Phos. Co.*, 3 App. Cas. 1236; *Telegraph v. Loetscher*, 127 Iowa, 383, 101 N. W. 773, 4 A. & E. Ann. Cas. 667; *Hinckley v. Oil & Pipe Line Co.*, 132 Iowa, 396, 107 N. W. 629, 119 Am. St. Rep. 564; *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 523; *Yeliser v. U. S., etc. Co.*, 107 Fed. 340, 52 L. R. A. 724.

aware that the property which they are asked to buy is the property of the promoters; and who shall be competent, and impartial judges, as to whether the purchase ought, or ought not to be made."²²

He is bound, "To misrepresent nothing which would influence the company in determining whether to buy or not; to conceal nothing that it was material should be known in order to enable them to form a sound judgment on that question; and to put them in possession of all material information; further, it was above all, the duty of Dr. Sloan, as a vendor selling property to a company, toward which he stood in a fiduciary relation, to see that the executive management of the company was in the hands of a thoroughly independent board of directors. A board which would, as the expression is, keep him at arms' length in making the bargain."²³ The disclosure as mentioned in the reports, means a full, fair and complete disclosure of his interest. It is not usually sufficient that the promoter has indicated or suggested that he has some little interest in the contract or transaction, but it is incumbent upon him to state the general nature of his interest, and in some cases, the cost of the property, and the profit he expects to realize.²⁴ It is generally believed that this disclosure can be made either to an independent and impartial board of directors; or it might be printed in the prospectuses if circulated prior to subscriptions to the stock, or it might be made direct to the stockholders of the corporation. In either of which cases, it is believed it will bind the corporation.²⁵

²² *Erlanger v. New Sombrero Phos. Co.*, 3 App. Cas. 1236.

²³ *In re Hess Mfg. Co.*, 23 S. C. of Canada, 644.

²⁴ *Alger on Promoters and Promotions*, § 33.

²⁵ *Simons v. Vulcan Oil Co.*, 61 Pa. 202, 100 Am. Dec. 628; *Densmore v. Densmore*, 64 Pa. 43; *Yelser v. U. S., etc. Co.*, 107 Fed. 340, 46 C. C. A. 567, 52 L. R. A. 724; *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725.

Many schemes and devices have been invented by promoters from time to time, to enable them to secure secret profits in such transactions. A very prevalent form is to have the property transferred to some person who acts the part of a dummy for the promoter, with the understanding that the property shall be, by him, turned over to the corporation for a certain consideration, which consideration, after the real cost of the properties has been taken out, is turned over to the promoter.

Of course, where this scheme can be proven, the corporation can elect one of two remedies. It may either rescind the contract, or it may require the promoter to turn over to it the profits received.²⁶ The same rule will apply where the promoter has a secret agreement with the actual owners of the property, and where the corporation purchases direct from such actual owner, and such owner, then in turn, delivers to the promoter a part of the consideration, which is nothing more or less than his profit.²⁷ In other words, he will not be permitted to keep secret profits, earned during the time that he was acting as promoter of the corporation, no matter what the scheme or device used for the purpose of getting possession of such profits is.²⁸ The courts

²⁶ *Whaley Bridge Calico Printg. Co. v. Green*, L. R. 5 Q. B. D. 109.

²⁷ *Simons v. Vulcan Oil & Ming. Co.*, 61 Pa. St. 202, 100 Am. Dec. 628; *Chandler v. Bacon*, 30 Fed. 538; *Densmore v. Densmore*, 64 Pa. St. 43.

²⁸ *Lomita Land, etc. Co. v. Robinson (Cal.)*, 97 Pac. 10, 18 L. R. A. (N. S.) 1106; *In re Lady Forrest Gold Ming. Co.*, 1 Ch. 582; *Pittsburg Ming. Co. v. Spooner*, 74 Wis. 307, 17 Am. St. Rep. 149; *Hayden v. Green*, 66 Kan. 204, 71 Pac. 236; *See v. Hepenheimer*, 61 Atl. 854; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; *Telegraph v. Loetscher*, 127 Ia. 383, 101 N. W. 773, 4 A. & E. Ann. Cas. 667; *Hinckley v. Oil & Pipe Line Co.*, 132 Ia. 396, 107 N. W. 629, 119 Am. St. Rep. 564; *Cuba Colony Co. v. Kirby*, 149 Mich. 453, 112 N. W. 1133; *Scott v. Farmers' & Merchants' Natl. Bank*, 97 Tex. 31, 75 S. W. 7, 104 Am. St. Rep. 835; *Fountain Spring Park Co. v. Rob-*

not only condemn contracts and transactions having for their purpose the securing to the promoter of secret profits, but prevent the promoter from taking any advantage of the other stockholders.²⁹

Where a promoter has purchased property not for himself, but for a corporation to be afterwards organized, the company will be entitled both to keep the property and call upon the promoter to repay the profit he has made, as his relation would be construed in law, at the time of the purchase, as that of an ordinary agent; and as soon as the corporation is brought into existence, he will be held to be a trustee, holding the property for the corporation; and where a promoter owns property in his own name and right, having acquired the same prior to the formation of the company, and afterwards sells it to the corporation at an advanced price, and thereafter induces and procures others to purchase stock in the corporation, upon the representation that the corporation has secured the property at its cost price, he is liable to the purchasers of such stock.³⁰

Where the promoter acquires property in his own name after having started to promote the organization of the corporation and acquired such property for the sole purpose of selling it to the corporation, when the organization of the corporation is completed, he will

ertson, 92 Wis. 345, 53 Am. St. Rep. 917; Old Dominion Copper Co. v. Bigelow, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; Pietsch v. Milbrath, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 107 Am. St. Rep. 1017, 68 L. R. A. 951; Camden Land Co. v. Lewis, 101 Me. 78, 63 Atl. 523; Mason v. Carrothers, 105 Me. 392, 74 Atl. 1030.

²⁹ Midwood Park Co. v. Baker, 128 N. Y. S. 954; Travis v. Travis, 124 N. Y. S. 1021; Mangold v. Adrian Irrigation Co., 60 Wash. 286, 111 Pac. 173.

³⁰ Ex-Mission Land & Water Co. v. Flash, 97 Cal. 610, 32 Pac. 600; Getty v. Devlin, 54 N. Y. 403; Pittsburg Mining Co. v. Spooner, 74 Wis. 307, 17 Am. St. Rep. 148; Hayden v. Green, 66 Kan. 204, 71 Pac. 236; Wills v. Nehalem Coal Co., 52 Ore. 70, 96 Pac. 528.

be required to surrender any secret profit made by him in the transaction.

§ 10. **Corporation purchasing property from promoter.**—While the law is clearly and well settled, beyond debate or question that frauds, secret profits, undue advantage over the corporation or its stockholders, concealment or otherwise, will not be tolerated by the courts, the law is also clear and well settled, that legitimate contracts between the corporation and the promoter will be upheld under certain conditions, that is, where the promoter has first provided the corporation with an independent, competent and trustworthy board of directors, and has disclosed to such board of directors, or the stockholders, his interest, in a full, fair and open manner.

In the *Erlanger* case, Lord Cairns on this question says: "I do not say that the owner of property may not promote and form a joint stock company, and then sell his property to it, but, I do say, that if he does, he is bound to take care that he sells it to the company through the medium of a board of directors, who can and do exercise an independent and intelligent judgment on the transaction, and who are not left under the belief that the property belongs not to the promoter, but to some other person."³¹ The Supreme Court of New Jersey,³² following the rule laid down in this case says, "Buck, as a promoter of the corporation, stood in a fiduciary relation to the company, as soon as it was organized. As such promoter, it was open to him to sell the property which he owned to the company, on

³¹ *Erlanger v. New Sombrero Phos. Co.*, L. R. 3 App. Cas. 1218.

³² *Plaquemines Tropical Fruit Co. v. Buck*, 52 N. J. E. 219; see also *Old Dominion Copper Co. v. Bigelow*, 203 Mass. 159, 89 N. E. 193; *Old Dom. Copper Co. v. Lewisohn*, 210 U. S. 206, 52 L. Ed. 1025; *Tompkins v. Sperry*, 96 Md. 560, 54 Atl. 254; *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725.

making full and fair disclosure of his interests and position with respect to this property. Not only was such disclosure necessary, but it was incumbent on him as sole promoter of the company, formed to purchase this special property, controlling, moulding its organization, to furnish it with an executive board of directors, capable of forming a competent and impartial judgment as to the wisdom of the purchase and the price which was paid."

A few courts have gone to the extent of adopting a rule that where full disclosure is made to all of the stockholders of the corporation, it will be unnecessary for the promoter to furnish the corporation with an independent and competent board of directors; that the disclosure to the stockholders will be a complete fulfillment of all his duties in that regard.³³

Typical of this class of cases is that of *Parson v. Hayes*. The corporation, in this case was a mining company organized under the laws of the State of New York. After the organization of the corporation had been perfected, the directors named in the articles of incorporation purchased for the corporation certain mining property, and issued the entire capitalization of \$2,000,000 in payment therefor. At the time of such transaction, the board of directors well knew that the property thus purchased was worth less than \$150,000. Thereafter, the vendor of the property donated back to the corporation, a certain number of the shares of stock acquired from the corporation for the mining property, which stock was afterwards acquired by an innocent purchaser, who, upon the discovery of the facts instituted an action against the corporation and its directors, praying that the individuals be required

³³ *Lagunas Nitrate Co. v. Lagunas Nitrate Syndicate*, 2 Ch. 392; *Parson v. Hayes*, 14 Abb. N. Cas. 419; *Foster v. Seymour*, 23 Fed. 65; *Old Dominion Copper Co. v. Lewisohn*, 136 Fed. 915.

to account to the corporation for the difference between the value of the mine and the par value of the stock. The court held that, by reason of the fact that all of the acts complained of were done with the knowledge and consent of all of the stockholders, neither the corporation nor any of its stockholders would be heard to complain.

Mr. Morawetz, in his very able work on corporations, endorsing this decision says, "The vendor of the property in truth took back what he gave. He placed the property in the corporate name and at the same time practically became the corporation by becoming the sole stockholder. Evidently, therefore, no person was injured by that transaction. If subsequent transferees of shares were deceived by false representations that the whole amount of the shares had in fact been paid into the treasury of the company, their claim should have been for damages caused to themselves individually, through the false representations, and not for an infringement on the collective or corporative rights of all of the stockholders." The Supreme Court of the United States has endorsed this rule.³⁴ The Supreme Court of Washington in a recent case, after approving the rule of the United States Supreme Court, says, "A corporation cannot maintain an action to cancel stock issued to its promoters in exchange for property taken at an over-valuation, where no rights of creditors are involved and subsequent stockholders obtained full value in the purchase of their stock; and it is immaterial that the promoters were trustees of the corporation and in a measure dealing with themselves."³⁵

³⁴ *Old Dominion Copper, etc. Co. v. Lewisohn*, 210 U. S. 206, 52 L. Ed. 1025, affirming 148 Fed. 1020. See also *Foster v. Seymour*, 23 Fed. 65; *McCracken v. Robison*, 57 Fed. 375; *Northern Trust Co. v. Columbia Straw-Paper Co.*, 75 Fed. 936; *Old Dominion Copper, etc. Co. v. Lewisohn*, 136 Fed. 915.

³⁵ *Inland Nursery & Floral Co. v. Rice*, 57 Wash. 67, 106 Pac. 499.

That a broad exception to this rule should exist, is palpably apparent to all. The usual practice of incorporating and organizing corporations, as was done in the case under discussion, is to dispense with subscriptions to the capital stock prior to the holding of the organization meeting. The promoter will usually have an option of some kind on the property to be acquired and worked by the corporation. It will be understood between him and the owner of the property, if the promoter do not have an option, that the entire capital stock is to be issued as payment for the property, after which the owner will divide with the promoter, and thereafter a certain number of shares will be donated back to the corporation and placed in the treasury to be sold by the board of directors, to provide a working capital to operate the property.

Usually, this stock is intended for the innocent purchaser. This procedure enables the promoter to make full disclosure to all of the stockholders for they as a matter of fact are carefully limited to the incorporators, who are controlled by the promoter, and who understand the entire transaction. Of course, the organization meeting will be called and all the stockholders will be present and vote with full knowledge of all of the facts incident to the transaction, at the same time carrying out the plans of the promoter.

Now, simply because the promoter is shrewd enough in his manipulations to side step the courts, by limiting the members to persons under his control is no excuse for the courts to say to him in return, "Well done. Go hence, free from all general liability for your frauds." Why this whole transaction should not be held to be permeated with fraud, deceit and deception from its inception is very difficult to understand. From any possible standpoint, the whole transaction has for its purpose two objects: First, to place in the

hands of the promoter and his confederates, a large number of shares of the corporation, without the corporation receiving anything therefor, and, second, to create stock for the purpose of selling it to the innocent investing public.

Indeed, some of the courts have been very quick to discover that the real motive for such an arrangement has been to evade certain provisions of the law, and have met the manipulation with a better and more wholesome rule of law, and that is, "If one or more persons acquire property, intending to promote the organization of a corporation to purchase it from them at a profit to themselves and effect such purpose, limiting the membership to interested parties till the transaction is completed between them and the corporation, intending thereafter to cause the balance of the capital stock to be sold to outsiders, they being kept in ignorance of the true nature of such transaction, and effecting such intent, they are guilty of actionable fraud upon the corporation and responsible to it for the gains made. In such circumstances, in the making of the contract between the corporation and its agents, it is mere fiction as to its prospective members by original subscription, since it has no one to stand for it as an adverse party in the transaction, no meeting of adverse minds, essential to a binding contract, occurs. The corporation is deceived, in that advantage is taken of its incapacity to protect itself, as to the interests of prospective memberships by the original taking of its stock." ³⁶

³⁶ *Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 107 Am. St. Rep. 1018, 68 L. R. A. 945; see also *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725; *Old Dominion Copper Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; *Yeiser Paper Co. v. U. S., etc. Co.*, 107 Fed. 340; *Erlanger v. New Sombrero Phos. Co.*, L. R. 3 App. Cas. 1236; *In re Olympia, Ltd.*, 2 Ch.

"The corporation is in the hands of the promoter like clay in the hands of the potter. It is to this person, absolutely helpless and incapable of independent initiative or uncontrolled action that the promoter stands as trustee. It is not necessary to inquire how far he may be trustee also for shareholders or associates. In the present case the inquiry relates wholly to his obligation to the corporation. The fiduciary relation must in reason continue until the promoter has completely established according to his plan the being which he has undertaken to create. His liability must be commensurate with the scheme of promotion on which he has embarked. If the plan contemplates merely the organization of the corporation his duties may end there. But if the scheme is more ambitious and includes beside the incorporation, not only the conveyance to it of property but the procurement of a working capital in cash from the public then the obligation of faithfulness stretches to the length of the plan. It would be a vain thing for the law to say that the promoter is a trustee subject to all the stringent liabilities which inhere in that character and at the same time say that, at any period during his trusteeship and long before an essential part of it was executed or his general duty as such ended, he could, by changing for a moment the cloak of a promoter for that of director or stockholder, by his own act alone, absolve himself from all past, present or future liability in his capacity as promoter." ²⁷

It thus will be seen that the safer and more satisfactory plan for promoters in all cases, is first, to select an independent and competent board of directors,

153; *Wills v. Nehalem Coal Co.*, 52 Ore. 70, 96 Pac. 534; *Mason v. Carrothers*, 105 Me. 392, 74 Atl. 1030.

²⁷ *Old Dominion Copper Mining Co. v. Bigelow*, 203 Mass. 159, 89 N. E. 193.

and then be fair and above board with such board of directors in all of their dealings with the corporation. We cannot pass this question without suggesting, in this connection, that the promoter should for his own protection be careful to see to it that all the necessary requisites have been complied with by him before he undertakes to sell property in which he has an interest, to a corporation that he has organized. The promoter will find the stockholders of his corporation much more liberal and generous in making allowances to him in the nature of profits and demands, at the time when the corporation is just beginning its operations; for then there is in sight great profits for the corporation and its stockholders; and all are apparently on the road to fortune, greatness, and success, while, if he wait until the corporation has been in existence for a year or two and the promised realization of fortune and success has dwindled to ruined hopes and wrecked fortunes, and personal loss, then the stockholders can be depended upon to take every possible advantage of the promoter.

It is then that all the weaknesses in the scheme of promotion in the organization, and in the contracts made with the corporation will be tested and disclosed. The promoter will find it highly advisable, in all cases, not only to make a full and fair disclosure to his board of directors, but see to it that the disclosure is recorded among the records of the corporation, that is, that it be included in the minutes of the directors' meetings, and also of the stockholders' meetings.

In this way, many questions that have involved and ruined promoters can be eliminated, while at the same time the stockholders can not complain that they were not fairly dealt with, for it is an easy matter for them to examine the records of the corporation and find out exactly what was done. Again, promoters should see to it that their corporation is properly organized at its

inception, and fully understand their position, rights, duties and liabilities. If this be done, we venture to say that much litigation will be avoided and the general investing public will have a better opinion of the promoter, as well as the corporation that he has promoted.

§ 11. **Promoters' contracts entered into prior to incorporation.**—The weight of authority sustains the rule that contracts entered into, and obligations made by the promoter, prior to incorporation, are not binding upon the corporation.³⁸ However, such contracts have been held binding upon the corporation unless renounced and disapproved by its directors.³⁹

A corporation has power, when fully organized, to ratify contracts made by promoters when such contracts are within the purpose for which the corporation was organized, and appear to have been a reasonable means of carrying out its purposes, and, where the corporation consents, ratifies and adopts a contract made by its promoter, and accepts the benefits thereof, with full knowledge of the liabilities, it assumes all such liabilities.

In other words, it cannot accept the advantages and benefits and refuse to assume the obligations and liabilities.⁴⁰ No criticism can be found of the rule of law,

³⁸ *Hill v. Gould*, 129 Mo. 106, 30 S. W. 181; *Montgomery v. Whitbeck*, 12 N. D. 385, 96 N. W. 327; *Ruby Chief M. Co. v. Gurley*, 17 Colo. 199, 29 Pac. 668; *Bond v. Atlantic, etc. Co.*, 137 App. Div. 671, 122 N. Y. S. 425; *Tuttle v. George A. Tuttle Co.*, 101 Me. 287, 64 Atl. 496, 8 Am. & Eng. Ann. Cas. 260; *Bradford v. Metcalf*, 185 Mass. 205, 70 N. E. 40; *Munson v. Syracuse, etc. Ry. Co.*, 103 N. Y. 58, 8 N. E. 355; *Miser Gold, etc. Co. v. Moody*, 37 Colo. 310, 86 Pac. 335; *Chilcott v. Washington, etc. Co.*, 45 Wash. 148, 88 Pac. 113; *Fred Macey Co. v. Macey*, 143 Mich. 138, 106 N. W. 722, 5 L. R. A. (N. S.) 1036.

³⁹ *Girard v. Case Bros. Cutlery Co.*, 225 Pa. 327, 74 Atl. 201; *Bell's Gap Ry. Co. v. Christy*, 79 Pa. St. 54, 21 Am. Rep. 39; *Kimmerle v. Dowagiac, etc. Co.*, 159 Mich. 34, 123 N. W. 565.

⁴⁰ *Chilcott v. Washington State Col. Co.*, 45 Wash. 148, 88 Pac. 113; *Colo. Land & Water Co. v. Adams*, 5 Colo. App. 190, 37 Pac. 39;

that contracts entered into, and obligations made by a promoter prior to incorporation are not binding upon the corporation. Although there are times when it may create a hardship, it could not, with proper regard to reasonable protection to the corporation and its future stockholders, be otherwise. Any other rule would be "too susceptible of abuse to afford a safe guide in these lax times, when every possible avenue of corruption is sure to find one desperate enough to enter."

Again the promises of the average promoter are usually profuse and vague, so desperately beyond realization, so extravagantly optimistic and his representations so far reaching, that for the law to saddle them on the new born organization would be but signing its death warrant. That the average promoter has no degree of caution; that he is possessed of a reckless disregard for results; that he is sanguine and optimistic to the extreme and a colossal industrial dreamer, cannot be denied. This, we say, applies to that class of promoters who are honest of intention. In addition to this class, there is a set of promoters that might well be classed as unscrupulous, designing and lecherous. Taking one of that set, his whole make-up and all his transactions are permeated and steeped in fraud, deceit and wilful misrepresentations.

His whole career is made up of floating wild cat propositions, and gulling the innocent and unsuspecting public. The opportunities of the broad and inviting field of the great undeveloped resources of the commonwealth, and the ease with which the American people are gulled, taking into consideration the mad clamor for wealth, which reigns throughout the land, make such men and such circumstances. It is safe to say,

Schreyer v. Turner Flouring M. Co., 29 Ore. 1, 43 Pac. 719; Paxton Cattle Co. v. First Nat. Bank, 21 Neb. 621, 59 Am. Rep. 852; Rogers v. New York, etc. Land Co., 134 N. Y. 197, 32 N. E. 27.

however, that the average promoter is well meaning and honest of intention, only that he is led away by his colossal dreams, his optimistic visions, and his hope of accomplishing great results.

Thus, it is repeated that, regardless of the frauds which might enter into promoters' contracts, for courts to require corporations to be bound by his contracts prior to incorporation, would be to saddle it with burdens, responsibilities and liabilities, which it would be unable to carry. In Vermont and New Hampshire, an exception is noted to this general rule of law, which is of very little importance to the promoter, and that is, where the promoter, prior to the organization of the corporation, after signing the articles of incorporation, makes contracts with third persons to secure subscriptions to the capital stock, which subscriptions are thereafter accepted by the corporation, it is held by the acceptance of such subscriptions that the corporation also ratifies and adopts the contracts of the promoter in reference thereto, and is liable according to the terms thereof.⁴¹

These decisions do not seem to have met with favor among the text writers nor the courts.⁴² The Supreme Courts of Missouri and Massachusetts have held that if a contract is made in the name, and for the benefit of a projected corporation, the corporation, after organization, cannot become a party to the contract, even by ratification or adoption of it, but a new contract is necessary.⁴³

⁴¹ *Low v. Conn. etc. Ry. Co.*, 45 N. H. 370; *Hall v. Vermont, etc. Ry. Co.*, 28 Vt. 401.

⁴² *Redfield on Railroads*, § 14; *Weatherford Mineral Wells, etc. Co. v. Granger*, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837; *N. Y., etc. Ry. Co. v. Ketchum*, 27 Conn. 170.

⁴³ *Queen City, etc. Co. v. Crawford*, 127 Mo. 356, 30 S. W. 163; *Abbott v. Hapgood*, 150 Mass. 248, 15 Am. St. Rep. 193.

§ 12. Promoters' personal liability for contracts made in the corporate name prior to incorporation.—The personal liability of promoters on contracts made in the name, and for the benefit of the corporation, prior to its organization has received more careful attention from the courts of England than those of this country. A number of courts have held promoters of a corporation personally liable for contracts made by them, or by agents authorized by them, preliminary to its organization.⁴⁴

The Supreme Court of the United States seems to have resolved the question to one of intent of the parties, which would seem to be a fair construction. Of course, the general presumption, where an agent contracts for and on behalf of a principal which has no legal existence, is that he is personally liable, which presumption, however, may be overcome by showing that the person contracting fully understood that he was to look for the future corporation.

If the contract is oral, then, as in the case of all oral contracts where there is dispute, it becomes a question for the jury to determine.⁴⁵ While, if the contract be in writing, the question of intent would seem to be a question for the court and not the jury.⁴⁶ The law seems to be that the question of intent cannot be explained and brought into the case by parol evidence, but it must clearly appear by the terms of the contract itself.

⁴⁴ *Hersey v. Tully*, 8 Colo. App. 110, 44 Pac. 854; *Whetstone v. Crane Bros. Mfg. Co.*, 1 Kan. App. 320, 41 Pac. 211; *Carmody v. Powers*, 60 Mich. 26; *Terwilliger v. Murphy*, 104 Ind. 32; *Abbott v. Hapgood*, 150 Mass. 248, 15 Am. St. Rep. 193; *Marshalltown, etc. Bank v. Church Fed. of Am.*, 129 Iowa, 268, 105 N. W. 578. But see *Alger on Promoters and Promotions*, §§ 225-230; *Whitney v. Wyman*, 101 U. S. 392.

⁴⁵ *Higgins v. Hopkins*, 3 Ex. 163.

⁴⁶ *Higgins v. Senior*, 8 M. & W. 834.

The English Court, commenting upon this question in *Higgins v. Senior*, *supra*, says, "We assume that the parties contemplated that the person signing it would be personally liable. Putting the words, 'On behalf' of the Gravesend Royal Alexander Hotel Co. would operate no more than if a person should contract for a quantity of corn on behalf of my horses."⁴⁷ If a promoter make a contract on behalf of a nonexistent corporation and conceal that fact, while he is not liable on the contract, he will be liable in damages for misrepresentation.⁴⁸ So, too, a promoter may be liable to a co-promoter for breach of duty, and in case of joint liability can enforce contribution from his co-promoter. A very difficult question rises where a promoter has attempted to organize a corporation, but fails to comply with the requirements of the statute of the State wherein incorporation is sought, or where, for any reason, he fails to bring the corporation into existence.

This failure might result from a number of different reasons. For instance: failure to comply with the prerequisite requirements of the statute of the State wherein incorporation is sought, or where the law under which the incorporation is sought is unconstitutional, or where a corporation of that particular kind, or for the objects and purposes sought to be carried out by such corporations is prohibited by law. It is believed that under any of these circumstances, a promoter is personally liable for all contracts made on behalf of such supposed corporation, or that he is liable for misrepresentation of the facts.

Thus, it has been held that where a promoter ordered certain goods for a corporation that was never organ-

⁴⁷ See generally upon this question, the question of "Agents."

⁴⁸ Alger on Promoters and Promotions, § 235.

ized, he was liable,⁴⁹ and where promoters after incurring certain debts abandon the scheme and fail to incorporate.⁵⁰ However, it would seem, on principle, that the promoter should not be held in all cases on such contracts, for the reason that the parties entering into the contract did not contemplate him as the other party to the contract, or look to him, or anyone else, except the alleged principal, who was not in existence. The remedy should be, on principle, and it is believed on authority, an action for misrepresentation.

Where several persons are working together in the promotion of the corporation, and equally interested in the common object, they will be held to be jointly and severally liable, as the law would construe them to be partners.⁵¹ Indeed, it may be said, that all of the propositions heretofore suggested as applying to a promoter, will apply to several persons acting in the capacity of promoters, and all will be amenable to the laws, rules and regulations as hereinbefore announced.

§ 13. Compensation.—We have heretofore suggested that contracts made in the name of the corporation prior to its existence will not be binding upon the corporation, unless the corporation has full knowledge of the facts after it has been brought into existence and ratifies such contracts, and the courts now universally hold that contracts entered into on behalf of the corporation prior to its existence cannot be enforced against such corporations.⁵²

⁴⁹ *Hub. Pubg. Co. v. Richardson*, 13 N. Y. S. 665.

⁵⁰ *Roberts Mfg. Co. v. Wright*, 62 Minn. 337, 64 N. W. 827; *Parsons v. Spooner*, 2 Hare, 102; *Middle Branch, etc. Co. v. Jones (Ia.)*, 115 N. W. 3.

⁵¹ *Boice v. McCormick*, 94 N. Y. S. 892.

⁵² See Sec. 11, "Promoters' contracts entered into prior to incorporation." *Morrison v. Gold Mountain Ming. Co.*, 52 Cal. 306; *Hawkins v. Mansfield Gold Ming. Co.*, 52 Cal. 513; *Ruby Chief Ming. Co.*

Hence, it would necessarily follow that the promoter is not entitled to compensation for services performed in bringing the corporation into existence, nor can he recover from the corporation for money spent on behalf of the corporation prior to its corporate existence;⁵³ and any attempt to take pay from the corporation by fraud and collusion with the board of directors by having voted to them corporate stock, will be promptly set aside by the corporation, as the issue of stock would be a violation of the rights of the stockholders of the corporation.

§ 14. Liability of the corporation for promoters' contracts entered into prior to incorporation.—From what already has been said, it is apparent that any contracts entered into by the promoters prior to the incorporation of the corporation, will not be binding upon the corporation. The theory of the law is that the corporation can have neither agents nor representatives prior to its existence; therefore it has no one to make contracts for it. This rule of law is now well settled in nearly every jurisdiction of the United States. Innumerable cases might be cited from which we select the following.⁵⁴ While such contracts are not binding on the corporation and cannot be made the basis of an action, from any standpoint, yet the corporation may

v. Gurley, 17 Colo. 199, 29 Pac. 668; *Stevenson v. Dubuque Ming. Co.*, 34 Ia. 577; *Bash v. Culver Gold Ming. Co.*, 7 Wash. 122, 34 Pac. 462; *Bond v. Pike* (Minn.), 111 N. W. 916; *Wright v. St. Louis, etc. Co.* (Mich.), 109 N. W. 1062.

⁵³ *Hinckley v. Oil Pipe Line Co.*, 132 Ia. 396, 107 N. W. 629, 119 Am. St. Rep. 564; *Rockford, etc. Co. v. Sage*, 65 Ill. 328; *Cook on Corporations*, § 657 (5th Ed.).

⁵⁴ *Winters v. Hubb Ming. Co.*, 57 Fed. 287; *Morrison v. Gold Ming. Co.*, 52 Cal. 306; *Ruby Chief Ming. Co. v. Gurley*, 17 Colo. 199, 29 Pac. 668; *Paxton v. Bacon Millg., etc. Co.*, 2 Nev. 257; *Heckla Consol. Gold Ming. Co. v. O'Neill*, 65 Hun (N. Y.), 619; *Bash v. Culver Gold Ming. Co.*, 7 Wash. 122, 34 Pac. 462; *Stevenson v. Dubuque, etc. Ming. Co.*, 34 Ia. 577.

ratify such contracts with such third persons and thereby validate them.⁵⁵

Adoption, or ratification on the part of the corporation of such contracts may be done either at a regular or special meeting of the stockholders, or it may be inferred from the use and conduct of the corporation.⁵⁶ On the other hand the law is well settled that a corporation will not be permitted to accept the rights and benefits accruing under such contracts without assuming with such rights and benefits the liabilities attached thereto. So that, if the corporation accept the benefits under contracts made by promoters prior to the incorporation, they will usually be bound to make good the liabilities attached to such contracts.⁵⁷

Where the promoter of a corporation took a lease in his own name for the benefit of the corporation, and after its organization it ratified his act, the lease became the property of the corporation,⁵⁸ and where a majority of the directors of the corporation had knowledge of the transaction and the corporation had accepted and retained the benefits of such contract, a ratification or adoption on the part of the directors was held unnecessary.⁵⁹ It is needless to suggest that the corporation is neither bound by, nor can it ratify agree-

⁵⁵ *Whitney v. Wyman*, 101 U. S. 392; *Bruner v. Brown*, 139 Ind. 600, 38 N. E. 318; *Hill v. Gould*, 129 Mo. 106, 30 S. W. 181; *Bond v. Pike* (Minn.), 111 N. W. 916; *Central Trust Co. v. Lappe*, 216 Pa. 549, 65 Atl. 1111; *Tuttle v. Geo. A. Tuttle Co.*, 101 Me. 287, 64 Atl. 496, 8 A. & E. Ann. Cas. 260 (and note); *Robbins v. Bangor*, 100 Me. 496, 62 Atl. 136.

⁵⁶ *Possell v. Smith* (Colo.), 88 Pac. 1064; *Schreyer v. Turner Flour, etc. Co.*, 29 Ore. 1, 43 Pac. 719; *Chilcott v. Wash. State Col. Co.*, 45 Wash. 148, 88 Pac. 113.

⁵⁷ *Schreyer v. Turner, etc. Co.*, 29 Ore. 1, 43 Pac. 719; *Chilcott v. Wash. St. Col. Co.*, 45 Wash. 148, 88 Pac. 113; 1 Cur. Law. 718, 719; *Trust Co. v. Lappe*, 216 Pa. 549, 65 Atl. 1111; *Bond v. Pike*, 121 Minn. 127, 111 N. W. 926.

⁵⁸ *Central Trust Co. v. Lappe*, 216 Pa. 549, 65 Atl. 1111.

⁵⁹ *Possell v. Smith* (Colo.), 88 Pac. 1064.

ments made by promoters, which are either forbidden by law or *ultra vires* to the corporation, for such contracts are wholly void.⁶⁰ Of course the corporation will always be held liable for contracts assumed by the articles of incorporation.⁶¹

The question whether or not a contract has been adopted or ratified by the corporation is a question of fact as distinguished from a question of law.⁶² In the latter case, it was held by a divided court that while a contract made by the promoter was not binding upon the corporation at its inception, yet it might be ratified by the president on the part of the corporation when it attained a legal existence and there being evidence that the services were performed at the request of the president, who also was the chief promoter of the company, they were, under the circumstances, questions of fact for the jury.

§ 15. **Promoters' frauds.**—The frauds practiced upon the corporation by its promoters are many and numerous, and partake of innumerable schemes. The most prevalent, however, of such frauds may be divided into three general classes: first, selling to the corporation property in which the promoter has an interest, which was acquired by such promoter for the purpose of selling to such corporation at a large increase over the purchase price, and which he does sell to his corporation at a large secret profit;⁶³ second, by accepting di-

⁶⁰ *Electric Fire Proof Co. v. Smith*, 99 N. Y. S. 37.

⁶¹ *Wetherford, etc. Co. v. Granger*, 86 Tex. 350, 24 S. W. 795, 40 Am. St. Rep. 837.

⁶² *Pittsburgh Ming. Co. v. Gintrell*, 91 Tenn. 693, 30 S. W. 248; *Oakes v. Cattaraugus Water Co.*, 143 N. Y. 430, 38 N. E. 461.

⁶³ *Ex-Mission Land Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; See *v. Heppenheimer*, 61 Atl. 854; *Pittsburg Ming. Co. v. Spooner*, 74 Wis. 307, 17 Am. St. Rep. 149; *Brewster v. Hatch*, 25 N. E. 505; *Chandler v. Bacon*, 30 Fed. 538; *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 44 L. Ed. 423; *Emma Silver Ming. Co. v. Grant*, L. R. 11 Ch. D.

rectly or indirectly large and unreasonable commissions or bribes;⁶⁴ and third, to so manipulate the affairs of the corporation as to secure to himself and his associates, large blocks of stock for which the corporation receives very little, if anything, of value.⁶⁵

The latter of these three methods is the most prevalent in the present day operations, and the most obnoxious, for the fact is notorious that stock thus secured is often used by the promoter as a bonus to interest influential men of means and standing to become *particeps criminis* in the scheme of defrauding the general investing public. The general scheme followed by the promoter is to select such men as he believes have influence and standing, who will assist him in the promotion of his enterprise, and donate to them a large number of the shares of such stock, for permission to use their names as officers or directors of the corporation.

This gives the enterprise a standing, at least among the persons familiar with the standing of such directors and officers, regardless of the real merits of the proposition promoted by the corporation, as it is usually found an easy matter to interest not only the friends of such directors and officers, but the general investing public as well, who purchase stock in the concern and make their investment upon the standing of the hired directors and officers, rather than the merit of the enterprise.

918; *Munson v. Syracuse Ry. Co.*, 103 N. Y. 58; *Old Dominion Copper Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; *Telegraph Co. v. Loetscher*, 127 Iowa, 383; *In re Lady Forrest Gold Mine*, 1 Ch. 582; *South Joplin Land Co. v. Case*, 104 Mo. 572, 16 S. W. 391; *Erlanger v. New Sombrero Phos. Co.*, L. R. 3 App. Cas. 1236; *Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 68 L. R. A. 951, 107 Am. St. Rep. 1017.

⁶⁴ *Whaley Bridge, etc. Co. v. Green*, L. R. 5 Q. B. D. 109.

⁶⁵ *Erlanger v. New Sombrero Phos. Co.*, L. R. 3 App. Cas. 1218.
(See cases cited in note 63.)

If the enterprise proves a success, of course, all is well, but if it fails, and such schemes usually result in failure, courts of equity usually endeavor to straighten out the tangle as best they can, often holding the hired directors for the damages resulting from their acts. Of course, the promoter is always liable for such frauds, that is, he is liable to the corporation for stock wrongfully secured by him. The old and familiar case of *Erlanger v. New Sombrero Phos. Co.* is typical of a familiar practice in the promotion of corporations. In that case, a Paris banker by the name of Erlanger organized a syndicate for the purpose of purchasing an island, said to contain valuable deposits of phosphates. The island was purchased at £55,000, and later, Erlanger arranged for the organization of a corporation for the purpose of buying the island from his syndicate, Erlanger selecting the first board of directors. The sale was arranged through his friend, who had no interest in the transaction. The corporation paid £80,000 in cash, and £30,000 in paid up shares. The price paid for the island was not disclosed to the corporation. Subsequently, the facts of the whole transaction were brought to light, and a rescission was sought upon the ground that the promoter, who was at the head of the syndicate, originally purchasing the island, had committed a breach of trust, and abused the relation in which he stood to the company, and had neglected to properly protect the corporation of which he was the promoter.

A rescission was decreed upon those grounds, holding that such acts of the promoter constituted fraud. Lord Cairns, in his opinion says, "I can not but regard a meeting at which two of the principal directors did not and could not attend; at which one who did attend and take part in the deliberations was at once a per-

son buying and selling; where the legal adviser present and assisting was virtually another vendor; and where the two remaining directors are not shown to have had the means of exercising, or to have exercised, any intelligent judgment on the subject, as little else than a mockery and a delusion."

So, in the case of *Atwood v. Merryweather*, where the owner of a mining property assisted in bringing about the organization of a corporation, and permitted his co-operator to secure some £3,000 for the purpose of getting up and organizing a corporation. In this case, Merryweather, the owner of the claims, had offered them for sale for £4,000. Later, in connection with one, Whitworth, he organized a corporation and sold the mining claims to it for £7,000, Merryweather taking £4,000 for his interest in the claims, and turning the balance, £3,000, over to Whitworth, as his part of the consideration received for the claims, for organizing and bringing about the sale.

Later, the stockholders discovered the agreement between Merryweather and Whitworth and asked that the contract purchasing the property be rescinded, which was done. The court in its opinion says, "Upon such a transaction, the court will hold that the whole contract is a complete fraud. I do not in the least say that where persons with their eyes open, know that the agent who secures them the bargain, is going to take money for it, that would not be all right enough. If the company knew this gentleman was to have this amount as promotion money, well and good, but here is a simple fraud and nothing else. Merryweather, knowing Whitworth's position with regard to the company, and that, as an honest man, Whitworth was bound to tell the company what price he bought the mines for, agreed that the mines should be sold to the company for £7,000

and that the real price, £4,000, should not be disclosed to the company."⁶⁶

§ 16. **Remedy of the corporation.**—Generally speaking, the corporation has the selection of one of two remedies; first, it may rescind the contract upon the discovery of the fraud practiced upon it, or it may recover the secret profits, bribes, or commissions that such promoter has received; or, where stock has been issued to such promoter without proper consideration to the corporation, it may be cancelled, or he may be required to pay a reasonable market value therefor.⁶⁷ If the corporation has selected its remedy with a knowledge of all the facts, it cannot revoke such selection and proceed upon any other right or remedy.⁶⁸ So too, either or both of these rights may be destroyed by laches after a discovery of the facts, or by ratification, expressed or implied.

A man who, with full knowledge of his case, does not complain, but deals with his opponent as if he had no case against him, builds up from day to day, a wall of protection for such opponent, which will probably defeat any future attacks upon it.⁶⁹ And the law is well

⁶⁶ *Atwood v. Merryweather*, 5 Eq. 464; see also *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221.

⁶⁷ *Pittsburg Min. Co. v. Spooner*, 74 Wis. 307, 42 N. W. 259, 17 Am. St. Rep. 149; *Ladywell Ming. Co. v. Brookes*, 35 Ch. D. 400; *Erlanger v. New Sombrero Phos. Co.*, L. R. 3 App. Cas. 1218; *Fountain Spring Park Co. v. Roberts*, 92 Wis. 345; *Atwood v. Merryweather*, 37 L. J. Ch. 35; *Emma Silver Ming. Co. v. Lewis*, 4 C. P. D. 396; *Hichens v. Congreve*, 4 Russ. 562; *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101, 42 Am. St. Rep. 159; *Brewster v. Hatch*, 122 N. Y. 349, 25 N. E. 505, 19 Am. St. Rep. 498; *Getty v. Devlin*, 54 N. Y. 403, 70 N. Y. 504; *Ex-Mission Land & Water Co. v. Flash*, 97 Cal. 610, 32 Pac. 600; *Wills v. Nehalem Coal Co.*, 52 Ore. 70, 96 Pac. 528; *Johnson v. Sheridan Lumber Co.*, 511 Ore. 35, 93 Pac. 470; *Lomita Land & Water Co. v. Robinson*, 97 Pac. 10, 18 L. R. A. (N. S.) 1106.

⁶⁸ *Bigelow on Fraud*, 436 (note). See generally the question of selection of remedies and fraud.

⁶⁹ *Vigers v. Pike*, 8 C. L. & F. 562.

settled that when the case of laches is at issue, the plaintiff is chargeable with such knowledge as he might have obtained upon inquiry, provided the facts already shown by him were such as to put a man of ordinary intelligence on inquiry.⁷⁰ Inasmuch as the fraud and misdealing of the promoter are a direct injury to the corporation, the right to institute and maintain action for restitution belongs to the corporation.

However, if the corporation for any reason neglects or refuses to bring such action, the stockholders may under proper circumstances, institute and conduct such litigation, but "it is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation, which usually belongs to the corporation, he should show, to the satisfaction of the court, that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances, or action in conformity to his wishes. He must make an earnest, not a simulated effort, with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits, or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it. The efforts to induce such action as complainant desires on the part of the directors, and of the shareholders when that is necessary, and the cause of failure in these efforts, should be stated with particularity."⁷¹

So too, the Supreme Court of Massachusetts⁷² in

⁷⁰ *Foster v. Mansfield Co.*, 146 U. S. 88, 36 L. Ed. 899.

⁷¹ *Hawes v. Oakland*, 104 U. S. 450, 26 L. Ed. 827.

⁷² *Dunphy v. Traveller Newspaper Association*, 146 Mass. 497, 16 N. E. 426.

Dunphy v. Traveller Newspaper Association, holds that it would be contrary to the fundamental principles of corporate organization to hold that a single stockholder can at any time launch the corporation into litigation to obtain from another what he deems to be due it, or to prevent methods of management which he thinks unwise. Intelligent and honest men differ upon questions of business policy. Any corporation acting by its directors or by votes of its members may properly refuse to bring a suit, which one of its stockholders believes should be prosecuted. In such a case the will of the majority must control.

It is only when the action of the corporation in refusing to proceed at the request of the stockholder is fraudulent as against him, or in disregard of his rights, that he can maintain a suit in his own name in the corporate right. The court cannot interfere in the management of corporations, in matters which are properly within their discretion, so long as their discretion is fairly exercised; and it is always assumed, until the contrary appears, that they and the officers obey the law, and act in good faith in all matters.

The above quotations are well supported by authorities.⁷³ However, it is to be noted, in passing, that there are several general exceptions to this rule. Thus, where a demand upon the corporation would be useless and unavailing, as when the corporation is in control of the guilty parties, there need be no demand upon the corporation to bring action.⁷⁴ A question that has

⁷³ *Lord v. Copper Minrs. Co.*, 2 Phill. Ch. 740; *Ninneman v. Fox*, 43 Wash. 43, 86 Pac. 213; *Dillon v. Lee*, 110 Iowa, 156, 81 N. W. 245; *Byers v. Rollins*, 13 Colo. 22, 21 Pac. 894; *Smith v. Bulkey*, 70 Pac. 958; *Home Ming. Co. v. McKibbin*, 60 Kan. 387, 56 Pac. 756; *Moore v. Silver Valley Ming. Co.*, 104 N. C. 534, 10 S. E. 679; *Horst v. Traudt*, 43 Colo. 445, 96 Pac. 259.

⁷⁴ *Wickersham v. Crittenden*, 93 Cal. 17, 28 Pac. 788; *Young v. Alhambra Ming. Co.*, 71 Fed. 810; *Gerry v. Bismark Bank*, 19 Mont.

often arisen in the courts is where two corporations have a common board of directors, and one board of directors has committed wrongs detrimental to the interests of one of the corporations, in order to protect the interests of another. Under such circumstances, it would seem that it is unnecessary for the stockholders of the injured corporation to make a demand before bringing suit for restitution.⁷⁵

"It is manifest," said the New York Supreme Court, "that the directors who would betray their trust would not, by a mere demand and assertion of his rights on the part of the minority stockholders, be transformed into champions of the interests of the stockholders before the courts or elsewhere, or endeavor in good faith to undo the wrongs committed or in process of commission by themselves. In effect, it would be requesting them to sue themselves. Such a demand, under these circumstances, would be futile, and may well be dispensed with."⁷⁶ Or it would seem that where the directors and officers of the corporation have abandoned their office, and the corporation has ceased to do business that no demand is necessary.⁷⁷

Of course, the same will apply where the whereabouts or addresses of the officers of the corporation are not known, and cannot with reasonable diligence be ascertained.⁷⁸ What we heretofore have said regarding the frauds and wrong doings of the promoter has been intended to be confined to his doings directly

191, 47 Pac. 810; *Forrester v. Boston, etc. Co.*, 21 Mont. 544, 55 Pac. 229; *Memphis, etc. Co. v. Woods*, 88 Ala. 630, 16 Am. St. Rep. 81, 7 South. 108; *Smith v. Dorn*, 96 Cal. 73, 30 Pac. 1024.

⁷⁵ *George v. Central Ry. Co.*, 101 Ala. 607, 14 South. 752.

⁷⁶ *Boaz v. Sterlingworth, etc. Co.*, 73 N. Y. S. 1039, 68 App. Div. 1.

⁷⁷ *Tennessee, etc. Ming. Co. v. Ayers*, 43 S. W. 744.

⁷⁸ *Wilcox v. Bickel*, 11 Neb. 154, 8 N. W. 436; *Sheridan Brick Works v. Marion Trust Co.*, 157 Ind. 292, 61 N. E. 666, 87 Am. St. Rep. 207.

with his corporation. The scope of this work does not permit of a general discussion of the many frauds and wrongs practiced upon the general investing public, which do not give a particular individual injury a cause of action against the promoter. It may, however, generally be said that the promoter is ordinarily bound by the general law of fraud and deceit, and where by misrepresentation he has induced a person to purchase stock or the property, he is liable for damages resulting from such misrepresentation.

The more prevalent class of misrepresentation indulged in by the promoters of corporations is misrepresentations contained in prospectuses, which invite subscription to the capital stock of the corporation. The courts, generally speaking, always have allowed some little latitude to documents of this character. That is, they are permitted to indulge in a little optimistic expectation, so long as the prospectuses do not deal with material misrepresentation of existing facts, or purported existing facts. Owing to the fluctuating and uncertain character of mines and transactions pertaining thereto, the courts are inclined to be more liberal and to permit a wider range in representations regarding such property than in other properties.⁷⁹

Officers or promoters of a corporation who issued a fraudulent prospectus to sell treasury stock are not liable in damages for the fraud to one who, in reliance upon it, purchases from an individual stock which is owned by him, and in which the corporation has no interest.⁸⁰

⁷⁹ *Southern Dev. Co. v. Silva*, 125 U. S. 248; *Eldridge v. Young America Co.*, 27 Wash. 297, 67 Pac. 703; *Humphrey v. Merriam*, 32 Minn. 197; *Tuck v. Downing*, 76 Ill. 71; *Whitney v. Haskell*, 66 Atl. 101; *Crocker v. Manly*, 164 Ill. 282, 56 Am. St. Rep. 196.

⁸⁰ *Cheney v. Dickinson*, 172 Fed. 109, 96 C. C. A. 314, 28 L. R. A. (N. S.) 359; *Peek v. Gurney*, L. R. 6 H. L. 377, 7 Eng. Rul. Cas. 527; *Greene v. Merc. Trust Co.*, 60 Misc. 189, 111 N. Y. S. 802, 128 App. Div. 914.

CHAPTER IV.

INCORPORATORS.

§ 17. Functions.

18. Number and qualifications.

19. When named as temporary board of trustees.

§ 17. **Functions.**—Incorporators are an indispensable part of incorporation. Their function is to sign and acknowledge the articles of incorporation; cause them to be filed with the proper officials; to pay the necessary fees in connection therewith, and to see that the certificate of incorporation is duly issued and to place the same in the hands of the trustees named in the articles of incorporation. With all that properly done their duties as incorporators are at an end.

The liability of incorporators is commensurate with the obligations imposed by virtue of the trust assumed. Thus the original incorporators are liable to a subscriber for the amount paid on his subscription upon their abandonment of the enterprise.¹

§ 18. **Number and qualification.**—The statutes of the several states generally designate the minimum number necessary as incorporators; also in some states, the number that must reside within the state. In all of the states, except sixteen the statutes require not less than three incorporators. Of those sixteen states, the statutes of Kansas, Montana, New Hampshire, Utah, and West Virginia require not less than five. In Nebraska, Iowa and Arizona any number of persons is

¹ *Miller v. Denman*, 49 Wash. 217, 95 Pac. 67, 16 L. R. A. (n. s.) 348; *Yale Gas, etc. Co. v. Wilcox*, 64 Conn. 101, 42 Am. St. Rep. 159, 25 L. R. A. 90, 29 Atl. 303; *Hudson v. West*, 189 Pa. 491, 42 Atl. 190.

sufficient. In Georgia, any number more than one. In Mississippi and Washington there must be two or more.

Usually the only qualification necessary for incorporators is, that they have capacity to contract. In some states it will be necessary for a certain number to reside within the state of incorporation. Generally a foreigner may act as an incorporator, if there be no statute prohibiting him from so acting. Married women may, under the statutes of nearly all of the states act as incorporators.² In California, a majority of the incorporators must reside within the state. In Utah, South Dakota and Idaho the statutes require that, at least, one of the incorporators must reside within the state. The majority of the states, however, have no statutory requirement as to the residence of the incorporators.

Generally speaking, in the absence of statutory requirements, incorporators need not be subscribers to the capital stock of the corporation.³ Montana and several states now have statutes expressly providing that incorporators need not be shareholders in the proposed corporation. A corporation, where authorized by express statutory authority, may act as an incorporator, but not otherwise.⁴ Where express statutory authority is given to a corporation to act as an incorporator, there is no question that such law is constitutional, in which event the corporation itself, or by its agents may act as incorporator.

§ 19. When named as temporary board of trustees.—
Where the incorporators are named as the temporary

² *Good Land Co. v. Cole*, 131 Wis. 467, 110 N. W. 895, 120 Am. St. Rep. 1056.

³ *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43.

⁴ *Denny Hotel Co. v. Schram*, 6 Wash. 134, 32 Pac. 1002, 36 Am. St. Rep. 130.

board of trustees, as is usually done, then, their functions and duties as trustees begin exactly where they left off as incorporators. Their first duty will be to call a meeting of the stockholders, commonly known as the organization meeting, for the purpose of accepting the charter, and, in some states, of adopting the corporate by-laws, and electing directors; and then, as directors, to elect officers provided for in the by-laws, and to further organize generally the work of the corporation.

As already has been noted incorporation of modern corporations is brought about by a promoter. He "brings together the persons who become interested in the enterprise." He "sets in motion the machinery, which looks to the formation of the corporation." In other words, it is a common practice for the promoter to select the incorporators, and name the first board of trustees, which of course gives him the power to say how, when and in what shape the corporation shall be brought into existence.

Usually, the incorporators are but dummies in the hands of the promoter, used for the purpose of satisfying the requirements of the statutes and to carry out his plans and purposes. Often, he will own the very property that the corporation will, when organized, purchase from him, or, the board of trustees selected by him; or he will hold an option on the same with very little, if any, money invested.

After the incorporation has been perfected, and in some cases, after the property has been transferred for the entire capital stock of the corporation, the functions of such incorporators and trustees will cease, and often they will resign, and give way to a permanent board of directors.

Three reasons have brought about this method of incorporating. First, the attempt to escape the statutory

and other liabilities for unpaid stock subscriptions; second, the belief that by this method, a promoter can sell to the corporation properties acquired by him for that purpose, at any profit he may see fit to make, and escape accounting to the corporation, or its future stockholders for such profits, and third, that the names of the real parties interested in the enterprise, for various reasons, may not be made public.

This method of incorporating, that is, with "dummy" incorporators, is legal; for as a matter of fact, the whole organization is planned and carried out by the promoter, who is always guided by skilful attorneys. It is common knowledge that the only thing required of these dummy incorporators is to sign certain documents, often never read by them, for the purpose of making a paper record. While the United States Supreme Court⁵ has sanctioned the legality of corporations thus organized, it is evident from the reading of the report of this case that its moral status is not above criticism.

⁵ *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 44 L. Ed. 423. Compare *Louisville Bank Co. v. Elsenman*, 94 Ky. 83, 21 S. W. 531, 42 Am. St. Rep. 335.

CHAPTER V.

ARTICLES OF INCORPORATION.

- § 20. General.
- 21. Corporate name.
- 22. Objects and purposes.
- 23. Capitalization.
- 24. Par value.
- 25. Number of directors.
- 26. Principal place of business.
- 27. Amendments to articles of incorporation.
- 28. Change of the corporate name.
- 29. Amending objects and purposes.
- 30. Increase or decrease of capitalization.
- 31. Changing par value.
- 32. Increase or decrease of number of directors.
- 33. Changing the principal place of business.

§ 20. **General.**—The articles of incorporation, sometimes called the certificate of incorporation, is the instrument by which the corporation is formed. The execution of this instrument is, in fact, the first real step toward actual incorporation. The articles of incorporation always must be in writing, and contain all the necessary requirements of the statute of the state wherein incorporation is sought, which are usually: the name of the corporation; the objects and purposes for which it is formed; the term for which it is to exist, not exceeding the maximum time allowed by law; the number of directors or trustees, together with the names and addresses of the temporary board of directors or trustees; the amount of its capital stock; number of shares into which it is divided, and the par value of each; the principal place of business; the number of shares subscribed, and by whom.

If assessable or preferred stock is contemplated, it always should be provided for in the articles of incor-

poration, giving the amount thereof. Some states also provide for the publication in some newspaper, in the county in which the principal place of business is located, of a copy of the articles of incorporation, for a certain period of time.¹ The purpose of requiring this publication, is that all possible publicity shall be given to the creation of corporations, in order that the general public may be advised as to the nature of the corporate organization.² The state of Arizona, and a few other states, require also the highest amount of indebtedness, or liability, to which the corporation is at any time subject, to be stated, and likewise, the articles of incorporation to state whether or not private property shall be exempt from corporate debts.

“The certificate may contain any other provision for the regulation of the affairs of the corporation, or any limitation upon its power, and upon the powers of the directors and stockholders, which does not exempt them from any liability, or from the performance of any duty imposed by law.”³ Delaware, New Jersey, Connecticut and North Carolina have very similar provisions to the above quoted from the laws of New York. Those provisions give the incorporators an opportunity to place limitations and restrictions, not only on the directors in the management of the corporation, but on the majority stockholders as well.

Usually, the articles of incorporation must be subscribed and acknowledged before a notary public, and filed with the Secretary of State, and with the recording officer of the county wherein the principal place of business is located. The articles of incorporation are, in fact, the foundation of the corporation. It is that which

¹ Arizona, Florida, Georgia, Iowa, Louisiana, Minnesota, Mississippi, Nebraska, New Mexico, Rhode Island and Wyoming.

² *Seaton v. Grimm*, 110 Iowa, 145, 81 N. W. 225.

³ New York Business Corporation Laws, § 2.

enumerates the corporate rights, powers and privileges, under the law; it is that which lays the foundations of bringing into actual existence the corporation, and gives it power to act as a corporate body.

Aside from these functions of the charter, there is an important consideration. The law is well settled that the articles of incorporation, or charter, not only is the foundation of the corporation, and measure of its powers, but it also is the foundation and measure of the rights of the stockholders—rights that cannot be abrogated, or affected by any action of the majority of the stockholders, or any act of the directors. Mr. Cook, in his very able work on corporations, says, “The charter is a contract between the state and the corporation; second, it is a contract between the corporation and the stockholders; third, it is a contract between the stockholders and the state.”⁴ The importance of this consideration will be discussed more fully hereinafter. However, it is apparent from what already has been said, that the preparation and execution of the articles of incorporation is a most important consideration, and that the articles always should be drafted by an experienced and competent attorney. It is often a bothersome error for incorporators to follow some antiquated form in preparing the articles of incorporation, owing to the many and rapid changes in the general incorporation laws in the different states of the Union.

The articles of incorporation should be prepared for the particular corporation in view, taking into consideration the nature of the business intended to be carried

⁴ 2 Cook on Corporations (5th Ed.), § 492; see also *Garey v. St. Joe Mining Co.* (Utah), 91 Pac. 369; *Snook v. Georgia Improvement Co.*, 83 Ga. 61, 9 S. E. 1104; *Zabrieskie v. Hackensack, etc. Co.*, 18 N. J. E. 178, 90 Am. Dec. 617; *Colgate v. U. S. Leather Co.* (N. J.), 72 Atl. 126.

out, and everything directly or indirectly connected therewith; and, where the corporation is to be organized in one state for the purpose of carrying on all of its business in another state, care should be taken to examine the statutes of both states in drafting the articles of incorporation.

§ 21. **Corporate name.**—All corporations must have a corporate name. It is known by, transacts business, makes contracts, is sued and prosecutes suits in that name. Indeed, the name appears to be an indispensable part of the constitution of every corporation.⁵

In selecting the name, some degree of care should be exercised. It should not be identical with, or similar to the name of any other corporation, as that often leads to litigation, and eventually a change of the corporate name. Nearly all of the states now have statutes prohibiting a corporation from adopting the same name as an existing corporation, or a name so nearly resembling it, as to be calculated to deceive the general public. Even in the absence of statutes, the law is well settled that a corporate name regularly adopted and acquired is protected by courts of equity, on the same principle, and to the same extent, that individuals are protected in the use of trade marks.⁶ It has been repeatedly held that an injunction will issue at the instance of a corporation, against another corporation having and using its name, or a name so similar as to deceive and confuse the general public.⁷ The courts interfere in these

⁵ *Scarsdale Pub. Co.-The Colonial Press v. Carter*, 116 N. Y. S. 731; *Newby v. Oregon Cent. R. R. Co.*, Fed. Cas. No. 10,144.

⁶ *Holmes v. Holmes, etc. Co.*, 37 Conn. 278, 9 Am. Rep. 324; *Good-year India, etc. Co. v. Goodyear Rubber Co.*, 128 U. S. 598, 32 L. Ed. 535; *International T. Co. v. International L. & T. Co.*, 153 Mass. 271, 10 L. R. A. 758, 26 N. E. 693; *Michigan Savings Bk. v. Dime Savings Bk. (Mich.)*, 127 N. W. 364; *Rome, etc. Co. v. Davis, etc. Co. (Ga.)*, 68 S. E. 800.

⁷ *American, etc. Co. v. Am., etc. Co.*, 198 Pa. St. 189, 47 Atl. 936;

cases, not upon the ground that the state may not affix such corporate names as it may elect, to corporations created under its laws, but to prevent fraud, deception and imposition. It is common knowledge that identical, or similar names tend to create confusion and unfair dealings, as often a subsequent corporation thus secures trade and business rightfully belonging to a prior corporation. Indeed, this is often the very object in view in adopting a name identical with, or similar to, the name of an existing corporation having a reputation and standing in the business world or owning particular properties that are well known and valuable.

It is very doubtful if the law, as above stated, has any application to foreign corporations. The Supreme Court of the State of Illinois,⁸ passing upon this question, says, "The complainant is in the attitude of a foreign corporation, coming into this state, and seeking to contest the right to the use of a corporate name, which this state, in the furtherance of its own public policy, and in the exercise of its own sovereignty has seen fit to bestow upon one of its own corporations. For such a purpose a foreign corporation, ordinarily at least, can have no standing in our courts." For a general discussion of geographical reasons see the cases cited in the note.⁹

The name should always harmonize with the business expected to be carried on by the corporation. It should

Higgins v. Higgins Soap Co., 144 N. Y. 462; 39 N. E. 490, 27 L. R. A. 42, 43 Am. St. Rep. 769; Lamb v. Lamb, etc. Co., 78 N. W. 1072; Dodge Stationery Co. v. Dodge, 145 Cal. 380, 78 Pac. 879; Koebel v. Chicago, etc. Bureau, 210 Ill. 176, 71 N. E. 362, 102 Am. St. Rep. 154; Investor Pub. Co. v. Robinson, 72 Fed. 603; Michigan Sav. Bank v. Dime Sav. Bank, 162 Mich. 297, 127 N. W. 364, 139 Am. St. Rep. 558.

⁸ Hazelton Boller Co. v. Hazelton Tripod Boller Co., 142 Ill. 494, 30 N. E. 339.

⁹ Elgin National Watch Co. v. Loveland, 132 Fed. 41; Hoyt v. J. T. Lovett Co., 17 C. C. A. 657.

be reasonably short, and of a business taste. The form of the name is sometimes prescribed by statute, that it shall begin with "The" and end with "Company," "Corporation," "Society," etc., etc.¹⁰ The name need not be in English.¹¹

§ 22. **Objects and purposes.**—The articles of incorporation, or charter, is the foundation of the corporation, and the measure of its powers.¹² It is to be remembered that a natural person can do anything not forbidden by law, while a corporation can do only those things that are expressly or impliedly authorized by the laws of the state, and the articles of incorporation.¹³ In other words, the corporate powers of the corporation are limited by its charter, and it possesses only such powers as are expressly conferred by such charter, together with certain implied powers, or powers incidental to its existence.

The enumerated powers contained in the articles of incorporation are known as express powers, and must not exceed those permitted by the statute of the state where incorporation is sought. In addition to those

¹⁰ Colorado, Connecticut, Kansas, Delaware and North Carolina.

¹¹ In re Deutsch-Amerikanischer, etc., 200 Pa. 143, 49 Atl. 949.

¹² German Ins. Co. v. Commonwealth (Ky.), 133 S. W. 793; Vandall v. San Francisco Co., 40 Cal. 83; Whiteman Gold Co. v. Baker, 3 Nev. 351; George v. Nev., etc. Co., 22 Nev. 228, 38 Pac. 441; Dalles Lmbr. Co. v. Wasco, 3 Ore. 527; Franklin Natl. Bank v. Whitehead, 149 Ind. 560, 49 N. E. 591, 63 Am. St. Rep. 302; Trenton Potteries Co. v. Oliphant, 58 N. J. E. 507, 43 Atl. 723, 78 Am. St. Rep. 612, 46 L. R. A. 255; Bankers Mut., etc. Co. v. First Nat. Bk., 131 Iowa, 456, 108 N. W. 1046; People v. Ellison, 188 N. Y. 523, 81 N. E. 447; Spencer v. Alki Point, etc. Co., 53 Wash. 77, 101 Pac. 509, 132 Am. St. Rep. 1058; Colgate v. U. S. Leather Co. (N. J.), 72 Atl. 126; Salmon River, etc. Co. v. Dunn (Ida.), 3 West Coast Rep. 70; Lakin v. Willamette Val., etc. Co., 13 Or. 438, 11 Pac. 68, 57 Am. Rep. 25; O. R. & N. Co. v. Oregonian Ry. Co., 130 U. S. 20.

¹³ N. Y. Firemen's Ins. Co. v. Ely, 5 Conn. 560, 13 Am. Dec. 100, 7 Am. & English Enc. of Law (2d Ed.), 695; O. R. & N. v. Oregonian Ry. Co., 130 U. S. 20.

express powers, every corporation has certain implied powers, such as the right to the use of a corporate name; right to perpetual succession; right to acquire, hold and dispose of properties; the right to elect officers and appoint agents; to establish by-laws for its government; to sue and be sued.

Those implied powers belong to the corporation as a matter of right; hence, to ascertain the powers of a corporation, it is necessary first, to look to the laws of the state creating the corporation, and second, to the articles of incorporation. Thus, it will be seen that the section of the articles of incorporation, setting forth the objects and purposes, which are nothing more or less than an enumeration of the express powers, is a most important and vital section and should be drafted with the utmost care.

Generally speaking, in preparing this section of the articles of incorporation, two things should ever be kept in view. First, to include everything within a reasonable scope, connected with, or incidental to the business intended to be carried out, and, second, to exclude everything not permitted or authorized by the statute of the state, wherein incorporation is sought. Upon the latter proposition, the law is well settled that, if provisions unauthorized by law, are inserted in the articles of incorporation, such provisions are void, and any attempt to carry them into effect or operate under them will be an *ultra vires* act, or an act beyond the power of the corporation to carry out.¹⁴ The inclusion of unauthorized provisions will not, however, invalidate the articles, if enough authorized provisions are contained therein to permit the corporation to carry on a lawful

¹⁴State ex rel. v. Anderson, 67 N. E. 207; Ore. Ry. Co. v. Ore. Ry. Co., 130 U. S. 1; Western Union Tel. Co. v. Union Pacific Ry. Co., 3 Fed. 1; State v. Company, 88 Wis. 512, 60 N. W. 796.

business.¹⁵ It must be remembered, that corporations are not only bound within the spirit of the law of its creation, but, acting as foreign corporations, they are bound by the laws of the state, wherein they seek to do business.¹⁶ Under this rule, it has been held that, even though the corporations may have authority under the laws of its creation to do certain acts, yet if those acts are forbidden by the laws of the foreign state, wherein the corporation seeks to act, it will not be permitted to carry out such acts.¹⁷

Referring, now, to the proposition that the articles of incorporation should contain everything within a reasonable scope permitted by law, pertaining to, or in any way connected with the business intended to be carried on, it must be remembered that, formerly, corporations were organized under somewhat strict laws and adverse circumstances.

For many years, it was the policy of the law, and the practice of the times, to permit the organization of corporations for a single purpose only. However, a demand for capital to keep pace with the wonderful development of a great, growing, and undeveloped country, brought forth an era of organization and combination. The success attained by these combinations, brought forth consolidation, by natural consequences.

¹⁵ *Commonwealth v. Yetter*, 190 Pa. St. 488, 43 Atl. 226; *Tenn., etc. Co. v. Massy*, 56 S. W. 35; *Galveston Land & Imp. Co. v. Perkins*, 26 S. W. 256.

¹⁶ *Bishop v. Am. P. Co.*, 157 Ill. 284, 41 N. E. 765, 48 Am. St. Rep. 317.

¹⁷ *Bishop v. Am. P. Co.*, 157 Ill. 284, 41 N. E. 765, 48 Am. St. Rep. 317; *Harding v. Am. Glucose Co.*, 182 Ill. 551, 55 N. E. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738; *Coler v. Tacoma Ry. Co.*, 64 N. J. E. 117, 53 Atl. 680; *Coler v. Tacoma Ry., etc. Co.*, 65 N. J. Eq. 347, 54 Atl. 413; *People v. Howard*, 15 N. W. 101; *Floyd v. Natl. Loan, etc. Co.*, 49 W. Va. 327, 38 S. E. 653, 87 Am. St. Rep. 805; *Dunbar v. Am., etc. Co.*, 224 Ill. 9, 79 N. E. 423, 115 Am. St. Rep. 132; *State ex Inf. Hadley v. Standard Oil Co.*, 116 S. W. (Mo.) 902.

The country, after having passed through the panic of 1893, witnessed a rapid and remarkable change in incorporation laws, by reason of the consolidation of business enterprises on every hand.

Independent corporations were merged into gigantic and colossal combinations, organized for the purpose of carrying on almost every business known to the industrial world. The wail of politicians, and the protest of the people, who did not understand the wonderful transformation, were alike swept aside, and consolidation became a reality. Organizations with a capitalization which staggers the human conception, were a common occurrence. The great steel corporation, with its enormous capital of \$1,100,000,000 was organized, brought to life and began its operations to the wonder, astonishment and amazement of the industrial world. With the advent of consolidation, came the established practice of including, in a single charter, or articles of incorporation, every object and purpose known to, and permitted by the law. These new conditions in the laws of trade, demanded better and more liberal corporation laws, and a number of legislatures responded to this demand.

The courts in turn, while in some cases adhering to out of date ideas and antiquated precedents, generally responded to the needs of industrial progress, by construing such laws from a liberal and business standpoint.¹⁸ Naturally this rapid change from individual ownership of the great industries of the country, to corporate ownership, presented new and numerous questions under new and varying statutes and constitutional provisions. The result has been and is, that our corporation law, today, is in a formative and unfinished

¹⁸ The case that best illustrates this suggestion is the recent case of *Standard Oil Co. of N. J. v. U. S.*, 31 S. Ct. 502, Adv. S. U. S. 502, 55 L. Ed. 619, affirming 173 Fed. 177.

state, in many respects. Time and experience, however, are gradually reshaping the corporate laws, so as to keep pace with the industrial needs, demands and progress. Antiquated and inapplicable precedents are being swept aside, and every question settled and adjudicated from the standpoint of industrial demands and progress, with due respect to the rights of all classes.

As might be expected, a few of the states, seeing in new and liberal corporation laws, a splendid source of revenue to the state, have exceeded the industrial needs and demands, and have enacted laws as special inducements for corporations to apply to their state for organization, giving little or no protection to the stockholders. Generally, such laws will be found to be unsafe, both from the standpoint of the corporation or its stockholders, and from the standpoint of the investor. It has now become the established practice, and is under ordinary circumstances regarded as good judgment, to include, in the articles of incorporation, power to carry on everything pertaining, in any way, or connected with, the business proposed to be done by the corporation.

This feature has many advantages, and eliminates many heretofore serious and complicated questions, as a matter of law. As a matter of business, it has the merit of permitting the corporation to change its plan of operation, and engage under others, not contemplated by the organizers, when the corporation was organized. It is common knowledge that an undertaking, or enterprise, for which the corporation was organized often fails, and the ruined hopes of the stockholders and investors are protected only by changing from an unprofitable undertaking, to something that is profitable. It often happens that an unsuccessful mining company, is

turned into a successful and profitable smelting company.

Articles of incorporation with comprehensive powers are not only expected in the trade markets of the world, but such articles are established by the laws of trade, and have been upheld in the courts.¹⁹ Indeed, except in a very few states, the statutes are now very liberal in permitting corporations to be organized for the purpose of carrying on almost any lawful business.²⁰

We do not mean to intimate, nor to suggest, when we are advising that the articles of incorporation shall contain broad and comprehensive powers, that it is advisable for a company to be so organized as to permit its directors to drag it into all kinds of manipulations and schemes, but we do say that a corporation should have power to carry on any lawful business directly or indirectly connected with or pertaining to its main object.²¹

In the construction of the statutes of the different states, it is to be noted that where they enumerate a number of different purposes for which a corporation may be organized, and those different purposes are divided into classes by the conjunction, "or," they are construed to the effect that but one of such classes can be inserted in the articles of incorporation.

A mining corporation should have power by its articles of incorporation to locate, purchase, acquire, hold and operate mines and mining properties. It should also have power to purchase, acquire, own and operate

¹⁹ *Bird v. Daggett*, 97 Mass. 494; *West v. Crawford*, 80 Cal. 19, 21 Pac. 1123; *People v. Rice*, 138 N. Y. 151, 33 N. E. 846.

²⁰ See page 475.

²¹ The United States Steel Corporation, American Tobacco Company, American Leather Company, Northern Securities Company, and many other corporations of like character have very broad and comprehensive charters.

smelters, concentrating plants, and reduction works of all kinds, for the treatment and reduction of ores. As power is usually necessary to the successful operation of smelting and reduction plants, and as water powers are usually plentiful in the mountains, it should possess the right to appropriate water, develop water power, and electric power currents for its own use, and in some cases, for sale to the public. It may be that the company intends starting in a remote and isolated camp, or change to such a camp in the course of time; hence, it is right and proper, indeed often absolutely necessary, to own and operate saw mills; even telephone lines and tramways are sometimes regarded as necessities, and should be included among the enumerated powers. They should, however, always be confined to the business of the corporation.

Electric roads, as well as steam roads for the use of the company, but not as common carriers, are legitimate provisions. The construction and operation of tramways will often be found to be a necessity. It is further advisable to include among the express powers, those to acquire, own, sell, mortgage and exchange personal and real property of every kind; also to borrow money, execute notes, bonds, debentures, and other evidences of indebtedness.

So too, it is advisable to include within the articles of incorporation, the right and power of acquiring and holding stock in other corporations. There is no objection to including, in the articles of incorporation, some clause in reference to consolidation with other corporations, and often there is no objection to guaranteeing the bonds of another corporation. This latter provision, however, is never advisable, unless the corporation expects to operate in conjunction with other corporations in the same vicinity, or eventually consolidate the interests of all of the corporations and com-

panies operating in the same territory. (See Consolidation and Merger in this volume.) The corporation will, of course, have implied power to do that which is necessary, or usually incident to the corporate business.²²

In the absence of express provisions, corporations usually have implied power to borrow money for the necessary purposes of their organization.²³ Corporations also have implied power to issue evidences of indebtedness.²⁴ In other words, the rule seems to be that private corporations engaged in business, in the absence of some restraints in the statutes or charter have power to borrow money and execute evidences of indebtedness, in the same manner as an individual.²⁵ So, a corporation has implied power to pledge its bonds or other securities.²⁶ Corporations have no implied power or right to purchase the stock of other corporations.²⁷

In the absence of charter or statutory restrictions the rule is well settled in the United States, by the overwhelming weight of authority and reason, that a private corporation may purchase its own stock, if the transaction is fair and in good faith; if it is free from

²² North Side Ry. Co. v. Worthington, 88 Tex. 562, 30 S. W. 1055, 53 Am. St. Rep. 778.

²³ Union Gold Mining Co. v. Rocky Mountain Natl. Bk., 2 Colo. 248; Kent v. Quick Silver Mining Co., 78 N. Y. 159; Wright v. Hughes, 119 Ind. 324, 21 N. E. 907, 12 Am. St. Rep. 412; Helronimus v. Sweeney, 83 Md. 146, 55 Am. St. Rep. 333; Fidelity Trs. Co. v. Louisville Gas Co., 118 Ky. 588, 81 S. W. 927.

²⁴ Wright v. Hughes, 119 Ind. 324, 21 N. E. 907, 12 Am. St. Rep. 412; Andres v. Morgan, 62 Ohio St. 236, 56 N. E. 875, 78 Am. St. Rep. 712.

²⁵ Hays v. Gallon Gas Co., 29 Ohio St. 330; Memphis, etc. Ry. Co. v. Dow, 19 Fed. 388; Jones v. Guaranty Co., 101 U. S. 622, 25 L. Ed. 1030; Wright v. Hughes, 119 Ind. 324, 21 N. E. 907, 12 Am. St. Rep. 412; Deringer v. Deringer, 5 Houst. 416, 1 Am. St. Rep. 150.

²⁶ Ill. Trs. Co. v. Pac. Ry. Co., 117 Cal. 332, 49 Pac. 197; New Memphis Gas Co. Cases, 105 Tenn. 268, 60 S. W. 206, 80 Am. St. Rep. 880.

²⁷ Knowles v. Sandercock, 107 Cal. 629, 40 Pac. 1047.

fraud, actual and constructive; if the corporation is not insolvent, or in process of dissolution; and if the rights of its creditors are in no way affected thereby.²⁸

The Supreme Court of South Dakota, says that the purchase of its own stock by a corporation is necessarily a reduction of its capital, condemned by the plainest dictates of common policy.²⁹ Where an insolvent corporation buys its own stock, or the effect of such purchase is to render it insolvent, the transaction is void, as to existing creditors.³⁰

It will thus be noted that we have suggested powers that fall within the implied powers to be enumerated in the articles of incorporation as express powers. There can be no objection to this, and it has the merit of eliminating all questions as to the powers of the corporation. There may be some question, at times, as to the corporation's implied powers, but if they are enumerated among the express powers in the articles of incorporation, then there can be no question.

It may be said, generally, in addition to that which

²⁸ *Dacovich v. Canizas*, 152 Ala. 287, 44 South. 473; *Copper Belle Ming. Co. v. Costello* (Ariz.), 95 Pac. 94; *Rollins v. Shaver Wagon & Carriage Co.*, 80 Iowa, 380, 45 N. W. 1037, 20 Am. St. Rep. 427; *Hall v. Henderson*, 126 Ala. 449, 85 Am. St. Rep. 53, 28 South. 531; *Frazer v. Ritchie*, 8 Ill. App. 554; *Clapp v. Peterson*, 104 Ill. 26; *Coleman v. Columbia Oil Co.*, 51 Pa. St. 74; *U. S. Mineral Co. v. Camden*, 106 Va. 663, 56 S. E. 561, 117 Am. St. Rep. 1028; *Wis. Lmbr. Co. v. Greene, etc. Co.*, 127 Iowa, 350, 101 N. W. 742, 69 L. R. A. 968, 109 Am. St. Rep. 387; *Porter v. Plymouth Gold Min. Co.*, 29 Mont. 347, 74 Pac. 938, 101 Am. St. Rep. 569; *Atlanta, etc. Butter, etc. Ass'n v. Smith*, 141 Wis. 377, 123 N. W. 106, 135 Am. St. Rep. 42; *Gilchrist v. Highfield*, 140 Wis. 476, 123 N. W. 102, 17 A. & E. Ann. Cas. 1257; *Commercial Natl. Bk. v. Burch*, 141 Ill. 519, 31 N. E. 420, 33 Am. St. Rep. 331.

²⁹ *Adams and Westlake Co. v. Deyette*, 8 S. Dak. 119, 59 Am. St. Rep. 751, 59 N. W. 214.

³⁰ *Atlanta, etc. Butter, etc. Ass'n v. Smith*, 141 Wis. 377, 123 N. W. 106, 135 Am. St. Rep. 42; *Butler P. Co. v. Robbins*, 151 Ill. 588, 38 N. E. 153; *Hamor v. Taylor-Rice Co.*, 84 Fed. 392; *Hall v. Henderson*, 126 Ala. 449, 28 South. 531, 85 Am. St. Rep. 53.

already has been said, that under the charter and other general laws, the corporation may do or carry out anything that is in any way incidental to the objects and purposes of the corporation;³¹ and unless there is some statute prohibiting the particular act, or the act is in conflict with the articles of incorporation or charter, and incidental to the general objects and purposes of the corporation, it may be carried out. Corporations have power to make all necessary contracts to carry out the objects and purposes for which they are created.³² "Thus a business corporation has implied power to do that which is reasonably necessary to the business, or that which is usually incident to its prosecution, but this is the limit of its implied power."³³

The statute of the state wherein the corporation is organized must be consulted in all cases, and, as already has been suggested, nothing should be included among the enumerated powers, unless authorized by statute, as that might lead to trouble, and eventually serious litigation. It is usual and proper to close the objects and purposes of the corporation with a general clause, "To do any other things in connection with the objects and purposes that may be necessary, proper or convenient, to successfully promote the purposes of the corporation." However, this general clause has very little significance.³⁴

We have heretofore suggested that the statutes of

³¹ *Green Bay, etc. Co. v. Union Steamboat Co.*, 107 U. S. 98, 27 L. Ed. 413.

³² *Deringer's Admr. v. Deringer's Admr.*, 5 Houst. 416, 1 Am. St. Rep. 150; *Wright v. Hughes*, 119 Ind. 324, 21 N. E. 907, 12 Am. St. Rep. 412.

³³ *North Side Ry. Co. v. Worthington*, 88 Tex. 562, 30 S. W. 1055, 53 Am. St. Rep. 778; see also *Killingsworth v. Portland Trust Co.*, 18 Ore. 351, 23 Pac. 66, 7 L. R. A. 638, 17 Am. St. Rep. 737; *Wright v. Hughes*, 119 Ind. 324, 21 N. E. 907, 12 Am. St. Rep. 412.

³⁴ *Bird v. Daggett*, 97 Mass. 494; *In re Glenwood Co.*, 6 Pa. Co. Ct. 575.

several of the states permit provisions for the regulation of the affairs of the corporation to be inserted in the articles of incorporation. This is a favored practice in large corporations, having extensive interests. However, great care should be exercised under these provisions to see that the directors and stockholders are not unnecessarily hampered in conducting the affairs of the corporation with useless and unnecessary restrictions.

It is believed that corporations, can best carry out the purposes for which they are organized, by giving to the directors, free and independent control of its business affairs. These provisions, however, limited to a reasonable extent, furnish an excellent opportunity for supplying the means of protecting the minority stockholder.

Where property is conveyed to a corporation which is incompetent by its charter to hold such property, the conveyance is not void but voidable. The sovereign power alone can object to such a conveyance, and it is valid until assailed in a direct proceeding instituted for that purpose.³⁵

§ 23. Capitalization.—In determining the capitalization of a corporation, many things should be taken into consideration. All of the states with the exception of Arizona, Georgia, Louisiana and Washington have statutes fixing the incorporation tax, and recording fees, in proportion to the capitalization of the corporation. Again, a number of states require the payment of an annual franchise tax, which tax is levied and must be paid in proportion to the capitalization of the corporation. Among these states are Colorado, Delaware,

³⁵ Puget Sound Natl. Bk. v. Fisher, 52 Wash. 246, 100 Pac. 724; Union Natl. Bk. v. Matthews, 98 U. S. 621, 25 L. Ed. 188; Whitman, etc. Co. v. Baker, 3 Nev. 351; Scott v. Farmers, etc. Bank, 97 Tex. 31, 75 S. W. 7, 104 Am. St. Rep. 835.

Idaho, Maine, New Jersey, New York, Oregon and Ohio. The law is now generally well settled in many states that the capital stock of the corporation is a trust fund, for the benefit of the creditors. This question is fully discussed elsewhere in this work. However, it should be taken into consideration in determining the amount of the capital stock the corporation is to be organized with.

Taxes in some states should not be forgotten. We have seen many corporations, and especially mining and investment companies, with wild and reckless amounts as capital stock, wholly out of proportion to even the wildest dreams of the most enthusiastic, optimistic and visionary promoter. Some carry this to the extent of its being fraudulent on its face. Those, of course, are to be condemned without comment or excuse.

As a general proposition, the capitalization should be somewhere within the reasonable bounds of the enterprise, making, of course, due and proper allowances for contingencies that might arise in the future. The laws of trade, and the tendency of the times are inclined to favor reasonably large capitalization. This has always been true of mining and promotion companies. The fact that mining, especially developing a prospect, is an uncertain and hazardous risk, from the standpoint of the investor, requiring extraordinary inducements to interest capital for development purposes must and should be taken into consideration. In proportion to the risk taken, will the investor demand remuneration for his investment in case of success.

The established custom and practice of offering mining stock, during the experimental period, for from one to ten per cent. of the par value thereof is another reasonable and legitimate excuse for higher capitalization. By this custom and practice, little or no attention is paid

to the capitalization, nor the par value of the stock, but the price paid therefor is determined wholly by the represented showing, strike, or prospect of the mine. As the showing or prospect increases in wealth, so the stock increases in value, so that, all in all, it is a very equitable way of determining the true value of the stock.

Even in industrial and manufacturing corporations, experience is teaching investors to investigate and pay for stock, and give credit to the corporation, in accordance with the amount of property owned by the corporation, and pay very little, or no attention to the capitalization or par value of the stock, except of course, to determine the number of shares into which the property is divided. Our conclusion, then, is, that high, but not fraudulent capitalization is advisable, permissible, and should be had.

Capitalization in proportion to the prospective earning capacity of the enterprise, has always been considered advisable and legitimate. If large capitalization has for its object, "wild catting;" paying promoters exorbitant fees and expenses of organization; parceling out bonus stock to the trustees or officers; paying unreasonable commissions and salaries; or to be used for manipulations, or any of the many schemes and devices in the practice of getting something for nothing, so often indulged in; then, the whole plan, as well as the concern and its promoters, should receive immediate condemnation. Such acts are both a private and public fraud, and never should be tolerated.

Generally speaking, the capitalization of a corporation should not exceed the amount of capital necessary to place the corporation on a paying basis. After the capitalization is determined on this basis, then due allowance should be made for unforeseen contingencies, as it is better to have surplus shares than to be compelled to increase the capitalization of the corporation.

§ 24. **Par value.**—The number of shares and the par value thereof must usually be fixed in the articles of incorporation. This is made so by statute. In most of the states of the union, this sum may be fixed at any amount, while in a few of the states, the amount of the par value is fixed by statute, ranging from \$1 to \$100 per share. It is believed, however, that par value of stock has long since been deprived of its function and usefulness, and turned into a weapon of deceit.

It is to be remembered that under the plan of incorporating corporations, as originally adopted, the capital stock of the company was, in law, considered to be a guarantee fund for the payment of the creditors of the corporation. There resulted from this plan the fundamental proposition that the capital stock, being in the nature of a guarantee fund, should be paid for, at its par value, in actual cash. This proposition was at one time well recognized law. Thus, where the stock was fixed at 1,000 shares and the par value thereof at \$1.00 per share, and the whole of such stock was subscribed, it simply meant that there were \$1,000 in cash, in the treasury of the corporation, when it began business, which was its working capital.

That was the amount of the property that the corporation actually owned so that the shares issued were actually worth one hundred cents on the dollar, which was the par value thereof. By this method, it readily will be seen, that the actual value of the stock, when the same was issued by the corporation, was indicated by its par value, which was usually stamped on the face of the certificate. Of course, as the property of the corporation increased or decreased in value, the actual value of the stock increased or decreased in due proportion, but never changing its par value.

The first departure from the original plan as above indicated, was to permit the paying of the capital stock

of the corporation with either property or labor. These laws were immediately taken advantage of by a method of paying the capital stock with property at a fictitious and inflated valuation. That is, a corporation when organized, would issue its entire capital stock in payment for property, worth very often much less than the par value of the stock. Indeed, it would often happen that the property would be practically worthless.

This practice, sanctioned by law, in a few states, was followed in a number of others, by legislative enactments, permitting directors to fix an arbitrary value on certain kinds of property transferred to corporations, for the purpose of paying up its capital stock, which arbitrary value was made conclusive and binding, regardless of the actual value of the property, until it has come to pass, that a mining corporation, with a capitalization of a million dollars or more, may be paid with a mining property absolutely and totally worthless. That has gone on, we say, until in law and in practice, par value, as stamped on the face of every certificate of stock, amounts to practically nothing; has no significance, either in law, or in fact, and the law requiring the par value to be fixed in the articles of incorporation, is therefore simply a dead letter law, and may as well be repealed and wiped off the statute books.

Par value no longer furnishes the guide to determine the amount of cash, property or labor received by the corporation for its stock; nor does it furnish a guide as to the original value of the stock; it does not fix the selling price, as the law is now well settled that corporations may sell their stock for less than its par value. Again, par value as stamped on the face of certificates has a tendency to mislead and confuse the general investing public, who are not familiar with the fact that its useful properties and original functions have

been wiped out by law and practice. However, notwithstanding what has been said, the fact remains that the par value of the stock must be fixed and determined in the articles of incorporation, because the statutes of the several states so require.

In those states where there are no statutory provisions, it is believed that a par value of one hundred dollars per share is, for all purposes, a very good standard.

§ 25. **Number of directors.**—The qualifications, functions, duties and liabilities of the trustees or directors of a corporation are left for future consideration. Usually the number of directors are named and designated in the articles of incorporation. In some states, however, the minimum and maximum number are often named in the articles of incorporation, while the exact number is left for the by-laws. Thus, it is an advisable practice, where permitted by statutes of the state, to simply fix in the articles of incorporation, the minimum and maximum number of directors, and then in the by-laws, to fix and determine the exact number. This will give the corporation an opportunity to change, by increase or decrease, the number of its directors, when it so desires, without amending the articles of incorporation, thus saving the corporation unnecessary trouble and expense. In selecting the number of directors, the merits and demerits of a large and small board should be kept in view.

Experience shows that a small board of directors are more easily and readily assembled, and constitute a more efficient working body, in the discharge of their corporate duties. They are usually familiar with the business affairs of the corporation, and take a more responsible and active part in its management. They discharge their duties with less friction and delay. However, a large board is probably more advisable

than a small one. Hence, it readily will be seen that no ironclad, or fixed rule can be laid down as to the number of directors a corporation should have, but the incorporators must be governed wholly by their good judgment, after taking into consideration the local situation, the plan adopted to finance the enterprise, the scope and extent of their business, the plan of operating, and the statutes of the state wherein the corporation is created.

It is needless of course to suggest that stock in mining and promotion corporations is often sold upon the good standing of the board of directors and officers of the corporation, instead of upon the merit of the enterprise.

§ 26. **Principal place of business.**—The importance of the principal place of business of the corporation, should not be overlooked. Nearly all of the states have statutory provisions requiring the principal place of the corporation to be named and designated in the articles of incorporation, and it necessarily follows that the principal place of business must be located in the state of incorporation.

A corporation, in the strict sense of the term, cannot have a domicile outside of the state of its creation, although all, or the principal part of its business may be transacted and carried on in some foreign state.³⁶ The principal office of the corporation should be located in a proper and convenient place to transact and carry on the business, incident to the home office of the corporation. The seal, stock books, transfer books, together with the records of the corporation should be kept in this office,³⁷ unless express statutory permission

³⁶ *Ins. Co. v. Frances*, 11 Wall U. S. 210, 30 L. Ed. 77; *Taylor v. Branham*, 35 Fla. 297, 17 South. 552, 39 L. R. A. 362, 48 Am. St. Rep. 249.

³⁷ *State v. Park, etc. L. Co.*, 58 Minn. 330, 59 N. W. 1048, 49 Am.

is given by the state of its creation, to remove and keep the records of the corporation elsewhere. Indeed, it has been held that the failure of the corporation to maintain an office and keep its records within the state of its creation, is a good ground for declaring a forfeiture of its charter.³⁸

It would seem that even a majority of the stockholders cannot legally authorize the removal of the principal place of business, and the books and records of the corporation from and beyond the jurisdiction of the state of its creation. In the case of *McConnell v. Combination Min. & Milling Co.*, *supra*, the removal of the principal business office of the corporation, its records and funds, was authorized by a majority of the stockholders of the corporation, and the court held that such acts were *ultra vires* and void as to stockholders not consenting thereto, and not participating therein. In the course of his opinion Poorman, C., says, "Local stockholders had no means of ascertaining just what was done by the board of directors, except by journeying to St. Louis. These acts were without warrant or sanction of law and must therefore be held *ultra vires*, and not binding on any one who did not participate therein. It is true that corporations, organized in one state, may transact business in a foreign state. It is likewise true that persons who deal with corporations in such foreign state may be estopped from disputing the validity of the transactions. But we know of no principle of law that authorizes the corporation to move its principal office from and beyond the jurisdiction of the state in which the corporation was created."

St. Rep. 516; *Simmons v. Norfolk & Balt. S. R. Co.*, 113 N. C. 147, 18 S. E. 117, 22 L. R. A. 677, 37 Am. St. Rep. 614; *State v. Milwaukee*, etc. R. Co., 45 Wis. 579; *McConnell v. Combination Ming. & Mill. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703.

³⁸ *State v. Park*, etc. Lbr. Co., 58 Minn. 230, 59 N. W. 1048; *State v. Milwaukee*, etc. Ry. Co., 45 Wis. 579.

“It is also true that directors of a corporation may transact much business outside of the state, but they have no right to move the entire official business of the corporation beyond the state, and the acts of these directors in attempting to hold regular monthly meetings, and to sit as the board of directors of the corporation at St. Louis, Missouri, were acts *ultra vires*.”

The corporation is not only required to maintain its principal place of business, and keep its books, records, and the corporate seal, within the jurisdiction of the state creating it, but generally speaking, the meetings of the stockholders of the corporation must be held at its principal place of business, within the state. A few of the states require this by statute.³⁹ However, in the absence of such statutory provisions, the law is believed to be well settled that all stockholders' meetings, must be held within the state of incorporation of the corporation, unless express statutory permission and right is given by the statutes of such state to hold such meetings elsewhere. This seems to be the common law rule.⁴⁰ Where express statutory permission is given by the state where the corporation is organized, to hold the meetings outside of the state, then the meetings will be valid and the business transacted thereat binding upon the corporation. A number of states of the commonwealth now have such statutes.⁴¹

³⁹ Montana, California, Idaho and Washington.

⁴⁰ *Miller v. Ewer*, 27 Me. 509, 46 Am. Dec. 619; *Wood Hydraulic H. M. Co. v. King*, 45 Ga. 34; *Reichwald v. Com. Hotel Co.*, 106 Ill. 439; *Harding v. Am. Glucose Co.*, 182 Ill. 551, 55 N. E. 577, 74 Am. St. Rep. 189; *Hodson v. Duluth R. Co.*, 46 Minn. 454, 49 N. W. 197; *Freeman v. Machias Water, etc. Co.*, 38 Me. 343; *Montgomery v. Forbes*, 148 Mass. 249, 19 N. E. 342; *Ormsby v. Vermont Copper Ming. Co.*, 56 N. Y. 623; *Camp v. Byrne*, 41 Mo. 525; *Welsh v. Old Dominion, etc. Co.*, 10 N. Y. S. 174; *Smith v. Silver Min. Co.*, 64 Md. 85, 20 Atl. 1032, 54 Am. Rep. 760.

⁴¹ Alabama, Delaware, Michigan, Minnesota, Nevada, Pennsylvania and West Virginia.

So too, the law is well settled, that to complete the organization of the corporation, there must be an acceptance of the charter. This may be done by user, or acting under the charter.⁴² However, unless there is some act of acceptance, there is no corporation.⁴³ While there is probably no law requiring the corporation to accept the charter at a meeting held at the principal place of business of the corporation, yet the charter should be formally accepted at such principal place of business, and at the first stockholders', or organization meeting. There can be no question that the organization meeting must be held within the state creating the corporation; and any attempt to accept the charter outside of such state will be void.⁴⁴

Another thing that should be taken into consideration in connection with this question is the right of a stockholder to examine and inspect the books and records of the corporation. Nearly all of the states now have statutes requiring the corporation to keep their books and records open for inspection to the stockholders, during the usual business hours of the day, of every day, except Sunday and legal holidays. Of the Pacific states see cases cited in the note.⁴⁵ However, the right of a stockholder to examine and inspect the books and records of the corporation at all reasonable times, within business hours, and inform himself of the

⁴² Cook on Corporations, § 2a.

⁴³ *Smith v. Silver Min. Co.*, 64 Md. 85, 20 Atl. 1032, 54 Am. Rep. 760.

⁴⁴ *Smith v. Silver Min. Co.*, 64 Md. 85, 20 Atl. 1032, 54 Am. Rep. 760; *Taylor v. Branham*, 35 Fla. 297, 17 South. 552, 39 L. R. A. 362, 48 Am. St. Rep. 249; *Duke v. Taylor*, 37 Ala. 64, 19 South. 172, 31 L. R. A. 484; *Mitchell v. Vermont Copper Co.*, 67 N. Y. 280; *Camp v. Byrne*, 41 Mo. 525.

⁴⁵ *Ariz. Rev. Stat.* § 773; *Cal. Civil Code*, § 378; *Colo. Stat.* § 508; *Idaho Rev. Stat.* 2151; *Mont. Civ. Code*, § 541; *Nev.* 1903, as amended in 1905; *N. M. Comp. L.* § 451; *Ore. Mis. L.* § 3228; *S. Dak. Code*, § 444; *Rem. & Ball. Wash. Code* § 3701.

condition of the affairs of the corporation and its property, is a common law right.⁴⁶

Some states provide that any officer or agent of a corporation, who has in his custody or control any book, paper, or document belonging to the corporation who refuses to give to the stockholder, lawfully demanding, during business hours, the right to inspect or take a copy of the same, is guilty of a misdemeanor,⁴⁷ also imposing a penalty in favor of the injured party.⁴⁸

A stockholder is entitled to make this examination, inspection and demand at the principal place of business of the corporation, so that it would seem necessary to have and keep the books and records at that office for that purpose.⁴⁹ There are other reasons, also, from a legal standpoint, why it is necessary to keep and maintain the office of the corporation within the state of incorporation, but enough already has been noted, to show that it is almost absolutely necessary to do so. Stock always should be presented to that office for transfer.

§ 27. Amendments to articles of incorporation.—Statutes of the several states now generally provide that the articles of incorporation may be amended to include any change or matter that might lawfully have been included in the original articles. These statutes usually outline the necessary procedure to authorize and secure such amendments as may be desired.

⁴⁶ *State ex rel. v. Pac. Brew. Co.*, 21 Wash. 451, 58 Pac. 584; *State v. New Orleans Gas Light Co.*, 22 South. 815, 25 La. Ann. 413; *Lewis v. Brainard*, 53 Vt. 519; *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Huyler v. Cragin Cattle Co.*, 40 N. J. E. 392, 2 Atl. 274, 42 N. J. Eq. 139, 7 Atl. 521.

⁴⁷ Mont. Penal Code, § 989; 1 Rem. & Ball. (Wash.) 3702, and many other states.

⁴⁸ *Brown v. Kildea*, 58 Wash. 184, 108 Pac. 452.

⁴⁹ *State v. Park & Nelson Lmbr. Co.*, 58 Minn. 330, 59 N. W. 1048; *Simmons v. Norfolk & Balt., etc. Co.*, 113 N. C. 147, 18 S. E. 117, 22 L. R. A. 677, 37 Am. St. Rep. 614.

The usual procedure is to call a stockholders' meeting to authorize the proposed amendment. Usually from two-thirds to three-fourths of the outstanding stock is necessary to authorize an amendment. The first thing necessary, generally speaking, will be some step taken by the directors to authorize the sending out of a notice calling the meeting for the purpose of amendment. That notice, of course, must be issued by the proper authority setting forth the proposed amendment, also, calling the stockholders to assemble in a meeting for the purpose of acting upon such proposition. Care will always be taken to see to it that the notice is given as required by the by-laws, and in the manner therein prescribed.

The notice always will contain the time and place of the holding of such meeting. At the time and place fixed in the call, the necessary majority of stockholders should meet and vote upon the proposed amendment. A full and complete record must be kept of that meeting, containing a copy of the notice, and proof that the notice was duly and regularly given, in the manner provided by the statute and by the by-laws of the corporation.

If the required number of stockholders meet and vote in favor of the proposed amendment, the amended articles should then be prepared in strict conformity to the amendment proposed and voted upon, which articles will be executed and filed in the same manner as the original articles. Immediately upon filing and acceptance, the amended articles become and are, the articles under which the corporation will operate. The procedure outlined by the various statutes, is usually quite simple, and all that is necessary is that full compliance with these statutory provisions be had.

The laws of the state of the creation of the corporation will always govern in such matters. Upon exami-

nation of the various statutes it will be found that the laws are now quite liberal in extending to corporations the right to amend their articles of incorporation, or file supplemental articles. Amendments to particular sections of the articles of incorporation are discussed as there is some difference in the laws governing particular parts of the articles of incorporation.

§ 28. **Change of the corporate name.**—We heretofore have said that in selecting the corporate name, some degree of care should be taken for many reasons. This will be appreciated more fully when an attempt is made under some statutes to secure a change of the corporate name.

The law seems to look with more or less disfavor upon changing the corporate name, hence, when it is once adopted, often difficulty will be experienced in securing a change. At common law a corporation had neither the right nor power to change its corporate name.⁵⁰ However, many of the states of the Union now have statutes giving to the corporation the right to change its name, which statutes usually prescribe the procedure necessary to secure such change. In some states⁵¹ the change can be had by filing amended or supplementary articles of incorporation, after proper authorization by the stockholders. In Maine, Tennessee and Montana, it would seem that the name can be changed by a vote of the stockholders. In New York, it would appear that a petition to assume another name may be made to the Supreme Court held in the judicial district in which its principal office is situated. In Montana, the name may be changed by a majority of the stockholders of the corporation, duly assembled at

⁵⁰ *Sykes v. People*, 23 N. E. 391; *Cincinnati Cooperage Co. v. Bate*, 96 Ky. 356, 26 S. W. 538, 49 Am. St. Rep. 300.

⁵¹ Washington, Connecticut, North Carolina, Vermont, Florida, Kansas and Arizona.

any regular or special meeting, duly called for that purpose. In that state whenever the name is changed, altered or amended, it is the duty of the secretary of the corporation, to certify the same for record, to the Secretary of State, and to the County Clerk of the county, wherein the principal place of business of such corporation is situated.

After a corporation has changed its name, it will be presumed to have done so, in accordance with the requirements of the statute.⁵² The amended or supplementary articles should be executed and filed always in the same manner as the original articles. The laws of the state of incorporation will govern such matters.

§ 29. Amending objects and purposes.—Amendments having for their aim a change in the objects and purposes of the corporation, and launching the enterprise on entirely new fields of business than was originally contemplated, are, in some states, refused.⁵³ Usually, it may be said that the statutes of nearly all the states are now quite liberal in permitting such amendments, and the courts are quite broad in construing such statutes.⁵⁴

§ 30. Increase or decrease of capitalization.—The corporation has no implied power to increase or decrease its capital stock, but must find authority for so doing in the statute of the state or in its articles of incorporation.⁵⁵ Where an attempt is made to increase

⁵² *King v. Ilwaco, etc. Co.*, 1 Wash. 127, 23 Pac. 924.

⁵³ *Colorado and Pennsylvania.*

⁵⁴ *Bowie v. Grand Lodge*, 99 Cal. 392, 34 Pac. 103; *Day v. Mill-Owners, etc. Co.*, 75 Ia. 649, 38 N. W. 113; *Boca & L. R. Co. v. Sierra Valleys Ry. Co.*, 2 Cal. App. 546, 84 Pac. 298.

⁵⁵ *Scovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *Crandell v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560; *Ross-Meehan Co. v. Southern Mail Co.*, 72 Fed. 957; *Marion Trust Co. v. Bennett*, 169 Ind. 346, 82 N. E. 782, 124 Am. St. Rep. 228.

the capital stock of a corporation, and there has been a failure to comply with the law authorizing such increase, and stock thereafter has been issued upon the assumption that the capital stock has been increased, after the issuance of the entire capital stock of the corporation, such additional issue of stock is absolutely void.⁵⁶ An increase or decrease of the capital stock of a corporation, unless authorized by its charter, or by statute, cannot affect the rights of creditors existing before the change is made.⁵⁷

It is not sufficient that all of the stockholders join in a resolution to increase the capital stock of a corporation; but to authorize such increase, the statute of the state permitting the capital stock to be increased, must be complied with.⁵⁸ "A resolution passed by the board of directors of a corporation cannot fix in advance, the time for increasing the capital stock of the corporation, without reference to the action of the stockholders, or the method prescribed by statute."⁵⁹ An increase or decrease of the capital stock, is a fundamental change in the affairs of the company, and must be authorized by a majority of the stockholders, at a corporate meeting and in the manner prescribed by the state under whose laws the corporation is organized.⁶⁰ An unsuccessful attempt to increase the capital stock of a cor-

⁵⁶ *Scovill v. Thayer*, 105 U. S. 143, 26 L. Ed. 968; *Cartwright v. Dickinson*, 88 Tenn. 476, 12 S. W. 1030, 7 L. R. A. 706, 17 Am. St. Rep. 910.

⁵⁷ *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227; *Ross-Mehan, etc. Foundry Co. v. Southern, etc. Co.*, 72 Fed. 957.

⁵⁸ *Cooke v. Marshall*, 191 Pa. St. 315, 43 Atl. 314; *Marion Trust Co. v. Bennett*, 169 Ind. 346, 82 N. E. 782, 124 Am. St. Rep. 228; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203; *Chicago, etc. Co. v. Allerton*, 18 Wall. 233, 21 L. Ed. 902.

⁵⁹ *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203.

⁶⁰ *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203; *Newport, etc. Co. v. Mims*, 103 Tenn. 465, 53 S. W. 786; *Railway Co. v. Allerton*, 18 Wall (U. S.) 233, 21 L. Ed. 902.

poration will often involve the corporation in serious and vexatious litigation, as the corporation is always liable and answerable for a fraudulent increase of its capital stock, as well as being liable for issuing stock over and above the number of shares authorized to be issued by law.

Therefore, great care and caution should always be exercised to see to it that the proper authority is given to authorize the increase of the capital stock, and then see that the statute is fully complied with, in each and every step in increasing such capital stock. "When a corporation has issued certificates of stock to the full extent of all the shares, which by law, and the constitution of the company, it may issue, no court can order the issuance of other shares, because, in that respect, the powers of the corporation have been exhausted."⁶¹

The power to authorize such an increase is in the stockholders, and not in the directors. Therefore, the law is clear that to increase the capital stock of the corporation, there must be authority from the stockholders.⁶² The right to increase the capital stock of the corporation, being intended for the benefit of the joint owners, that is, the stockholders, can be exercised only by the stockholders themselves. The original stockholders have a right to subscribe for and hold such increased stock, according to their respective shares,⁶³ that is, when the stock of a corporation is in-

⁶¹ *Smith v. North Am. Min. Co.*, 1 Nev. 357; see also *Baker v. Wasson*, 59 Texas, 140.

⁶² *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203; *Eidman v. Bowman*, 58 Ill. 444, 11 Am. Rep. 90; *Chicago City Ry. Co. v. Allerton*, 18 Wall, 233, 21 L. Ed. 902; *Marion Trust Co. v. Bennett*, 169 Ind. 346, 82 N. E. 782, 124 Am. St. Rep. 228; *Theis v. Dun*, 125 Wis. 651, 110 Am. St. Rep. 880, 104 N. W. 985.

⁶³ *Humboldt Drive Park Ass'n v. Stevens*, 34 Neb. 528, 52 N. W. 568, 33 Am. St. Rep. 654; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Jones v. Concord, etc. Co.*, 38 Atl. 120, 68 Am. St. Rep. 650, 67 N. H. 234, 30 Atl. 614; *Hammond v. Edison Illuminating Co.*, 131

creased, while the stock belongs to the corporation until it is subscribed and paid for by the stockholders, yet, the stockholders of the corporation have a right, under the law, to subscribe for such stock, in such corporation, and a refusal of the corporation to permit any of them to subscribe for such stock, according to the respective shares held by each of such stockholders in such corporation, renders the corporation liable for damages.⁶⁴ However, it has been held that stockholders have no presumptive right to take at par new stock which the corporation has voted to sell to an outsider at four and a half times its par value.⁶⁵ Of course, the right to their proportionate share of such new stock, may, by the stockholders of the corporation, be waived,⁶⁶ and, where the stockholder fails to assert his right to his proportionate share of the new stock, and where he is guilty of unreasonable delay, waiver will be implied and presumed.⁶⁷ Stockholders having the right to such proportionate share of such new stock cannot raise the question that someone else has not such right.⁶⁸

The law is believed to be a little more strict in reference to decreasing the capital stock than increasing it. Of course, the general rules of law pertains, in a general way, to both increasing and decreasing. However, a number of states have statutes refusing to permit a corporation to decrease its capital stock, so long as it has unpaid and outstanding debts. Of course, the de-

Mich. 79, 90 N. W. 1040, 100 Am. St. Rep. 582; *Luther v. Luther Co.*, 118 Wis. 112, 94 N. W. 69, 99 Am. St. Rep. 977.

⁶⁴ *Gray v. Portland Bank*, 3 Mass. 364, 3 Am. Dec. 156.

⁶⁵ *Stokes v. Cont. Trust Co.*, 99 N. Y. App. Div. 337.

⁶⁶ *Hoyt v. Shenango Valley Steel Co.*, 207 Pa. St. 208, 56 Atl. 422; *Eldman v. Bowman*, 58 Ill. 444, 11 Am. Rep. 90; *Hammond v. Edlison, etc. Co.*, 131 Mich. 79, 90 N. W. 1040, 100 Am. St. Rep. 582.

⁶⁷ *Weidenfeld v. N. P. Ry. Co.*, 129 Fed. 305.

⁶⁸ *Crosby v. Stratton*, 17 Colo. App. 212, 68 Pac. 130.

creasing of the capital stock must always be done in such a way that it is fair, equitable and just to all its stockholders, and if any attempt is made to prefer some stockholders, to the detriment of others, the decrease will not be upheld in the courts.

From what already has been said it will be noted that the statute of the state wherein the corporation is created must be consulted, and carefully complied with in every regard, both in increasing and decreasing the capital stock, as many serious questions will result from an unsuccessful attempt to either decrease or increase the same.

As we have heretofore suggested, if an attempt is made to increase the capital stock, and such attempt fails, by reason of failure to comply with the laws governing such questions, and the corporation, assuming that it has lawfully increased its capital stock, thereafter issues stock from such increase, upon the assumption that the increase is legal, such stock is simply an over issue, and is wholly and totally void, even in the hands of innocent purchasers for value;⁶⁹ which will involve the corporation, and often the directors and officers thereof, in serious litigation.

§ 31. Changing par value.—The par value of the stock, as has heretofore been suggested, is generally fixed by the articles of incorporation, necessarily so by law. Frequently, however, it will be found convenient and advisable to change the par value. This is generally permitted by statute.

In the absence of statutory permission, corporations would have no right to change the par value of its shares. The procedure to change the par value of the stock is usually quite simple. A stockholders' meeting

⁶⁹ See chapter on over issued stock.

must be called and held, after a due and proper notice, and their authority to change the par value must first be secured, after which the amended articles of incorporation are drafted and filed. All that is necessary is that care be taken that the provisions of the statute permitting the change in the par value of stock, be fully complied with.

Generally speaking, on all questions of amendment, the statutes are clearly directory and not mandatory, so that substantial compliance with their terms and provisions is all that is necessary. However, when any amendment is made to the articles of incorporation, as a matter for the proper protection of the corporation and for the purpose of eliminating all doubt, care should be exercised to comply fully with the details and provisions of such statutes.

§ 32. Increase or decrease of the number of directors.
The general incorporation statutes of a number of states permit the maximum and minimum number of directors to be fixed in the articles of incorporation, while the exact number is left for the by-laws. In such states where the articles of incorporation are properly drawn, the number can be readily and easily changed, by amending the by-laws. However, a number of states, and probably a majority of them, require the exact number of directors to be fixed and named in the articles of incorporation, and in such it will be necessary to amend the articles of incorporation in order to change such number. In other states, the change of the number of directors is regulated by special statute. Thus in California, the number of directors may, by the majority of the stockholders of the corporation, be increased, or decreased, to any number, not less than three, who must be members of the corporation. After such change is made, a certificate stating the number of directors must be filed in the same manner as the origi-

nal articles of incorporation. So too, in Montana, the number may be increased or decreased, provided that the number of directors or trustees shall at no time be less than three, nor more than thirteen.

Before such change is made, it is necessary to secure the consent of the holders of two-thirds of the capital stock, which consent must be filed in the office of the corporation. When such consent is obtained and filed, notice of the intended change must be published at least once a week for three successive weeks in some newspaper, published in the county wherein the principal place of business is situated, giving the number to which it is intended to increase or decrease the trustees or board of directors.

Hence, it will be seen that it is necessary to consult the statute of the state under whose laws the corporation has been created to ascertain the procedure necessary and proper to secure a change of the number of the directors.

§ 33. Changing the principal place of business.—We have heretofore noted that it is necessary that the principal place of business of the corporation shall be fixed and designated within the articles of incorporation. The place of business must be within the state under whose laws the incorporation is had, hence, it is usually necessary to amend the articles of incorporation, in order to secure a change of such place.⁷⁰

The right to change such place, is of course a statutory right. However, it is generally believed that in the absence of a special statute giving the corporation right to change its principal place of business, such a change is permitted under the statutes permitting general amendments to be made to the articles of incorporation, which exist in nearly every state. The stat-

⁷⁰ Harris v. McGregor, 29 Cal. 124.

utes of many of the states not only give authority for changing the principal place of business, but outline the proper or necessary procedure to effect such change. It has been held that the board of directors has no right or power to remove the principal place of business of the corporation from and beyond the jurisdiction of the state in which the corporation was created, and in which the business is actually transacted.⁷¹

⁷¹ *McConnell v. Comb. Min. & Milling Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703.

CHAPTER VI.

ORGANIZATION.

- § 34. Stock Subscription.
- 35. Filing Articles and Paying Fees.
- 36. Sundry Requirements.
- 37. Effect of Failure to Comply with Statute.
- 38. Estoppel to Deny Corporate Existence.

§ 34. **Stock subscription.**—Having completed the articles of incorporation, which is the first actual step in the incorporation of the company, we now devote a short chapter to the next necessary steps in the incorporation, giving in detail the necessary acts and things to be done to complete and perfect the corporate existence.

The first thing that should be looked to, after the articles of incorporation have been prepared is to see to it that the necessary stock is subscribed. The general plan of organizing corporations, as practiced in most of the western states is that no subscriptions to the capital stock are made prior to the incorporation. However, a few states now require that the amount of capital stock actually subscribed shall be set out in the articles of incorporation.¹ Where there are no statutory provisions requiring subscriptions to the capital stock, none are necessary.² Failure to subscribe and pay for the capital stock cannot and does not affect corporate existence.³ In those states requiring sub-

¹ Montana, New Jersey, Idaho, Nevada, California and Minnesota.

² *Johnson v. Kessler*, 76 Ia. 411, 41 N. W. 57; *Minor v. Banks*, 1 Pet. (U. S.) 46, 7 L. Ed. 47.

³ *Baker v. Backus*, 32 Ill. 79; *Ferguson v. Company*, 78 Miss. 65, 27 South. 877; *Hammond v. Strauss*, 53 Md. 1; *People v. Chambers*, 42 Cal. 201; *People v. Bank*, 7 Colo. 226, 3 Pac. 214; *State ex rel v. Webb*, 97 Ala. 111, 12 South. 377; *Jones v. Hale*, 32 Ore. 465, 52 Pac. 311.

scriptions to the capital stock before commencing business, the amount varies greatly in the different states; thus: in Washington, the general incorporation statute requires that the full capital stock must be subscribed before the corporation commences business. This statute, however, does not necessarily apply to mining corporations, as Washington has a special statute providing that no subscriptions to the capital stock of a mining corporation are necessary.

That is, "Where the amount of the capital stock of such corporation consists of the aggregate valuation of the whole number of feet, shares, or interest in any mining claim in this state, for the working and development of which such corporation shall be or have been formed, no actual subscription to the capital stock of such corporation shall be necessary; but each owner in said mining claim shall be deemed to have subscribed such an amount to the capital stock of such corporation as under its by-laws will represent the value of so much of his interest in said mining claim, the legal title to which he may by deed, deed of trust, or other instrument vest, or have vested, in such corporation for mining purposes; such subscription to be deemed to have been made on the execution and delivery to such corporation of such deed, deed of trust, or other instrument; nor shall the validity of any assessment levied by the board of trustees of such corporation be affected by the reason of the fact that the full amount of the capital stock of such corporation, as mentioned in its certificate of incorporation, shall not have been subscribed as provided in this section; provided, that the greater portion of said amount of capital stock shall have been so subscribed; and, provided further, that this section shall not be so construed as to prohibit the stockholders of any corporation formed, or which may be formed for mining purposes, as provided in this section, from reg-

ulating the mode of making subscriptions to its capital stock and calling in the same by by-laws or express contract.”⁴

It would seem that Pennsylvania, at one time, had a statute similar to the above quotation from that of the State of Washington.⁵ Very few of the states of the Union have such statutes, so that, generally speaking, mining corporations fall within the general corporation acts, in so far as the amount of stock to be subscribed is concerned. When it comes to the question of the method of paying up such capital stock, then nearly all of the Western states have statutes, not only giving the directors of such corporations the right to purchase properties and to issue stock to the amount of the value thereof, in payment therefor, but also giving them the right to place an arbitrary value thereon, which arbitrary value is in law, the real value, regardless of what the actual value may be. This question is fully discussed in another part of this work.⁶

In Arizona, California and Montana, and in many other states, no subscriptions to the stock are necessary. In those states requiring a stock subscription prior to commencing business, the amounts usually range from ten to fifty percent of the capitalization. Ordinarily it is believed that statutes relating to the amount of stock subscriptions are not regarded as prerequisites to the existence of a corporation, and the fact that a corporation has no stock subscribed and has opened no formal stock books does not preclude the existence of a corporation *de facto*,⁷ unless, of course, the statutes of the state wherein the corporation is organized, expressly so provide. Notwithstanding this, however, it

⁴ Rem. & Ball, § 7347; *Davies v. Ball* (Wash.) 116 Pac. 833.

⁵ *In re Lancaster Ming., etc. Co.*, 30 Pa. St. 151.

⁶ Full-paid stock.

⁷ *Jones v. Hale*, 32 Ore. 465, 52 Pac. 311; *Roane Iron Co. v. Wis. Trust Co.*, 99 Wis. 273, 74 N. W. 818, 67 Am. St. Rep. 856.

always is advisable to comply, at least substantially, with each and every provision of the statute of the state wherein the corporation is created, and in those states where the statutes provide that a certain percent, or the whole of the capital stock, shall be subscribed prior to the commencement of the business of the corporation, the incorporators should always see to it that the required amount is subscribed, and in the manner prescribed by law.

It is to be noted here that there is a distinction between stock subscription, and the amount actually paid in. Some states provide that a certain percent of the capital stock must be paid in before the corporation will be permitted to commence business, while others simply provide that the stock, or a certain percent thereof, must be subscribed before commencing business. If a corporation attempts to transact business before the required amount is subscribed and paid in, as by law required, the state, in *quo warranto* proceedings could probably declare a forfeiture of the charter of the corporation. Again, corporations cannot enforce subscriptions to their capital stock, unless the statutes have been complied with.⁸

§ 35. Filing articles and paying fees.—After the articles of incorporation have been properly prepared, signed and acknowledged, and the necessary stock required by statute to be subscribed, has been subscribed, the next step will be to have them properly filed with the proper recording officer of the state, which is usually the secretary of state. The articles always must, of course, be accompanied by the necessary filing, and other fees required by the law to be paid. All of the states except Arizona, Georgia, Louisiana and Washington, now have statutes fixing the incorporation tax,

⁸ *Denny Hotel Co. v. Schram*, 6 Wash. 134, 32 Pac. 1002, 36 Am. St. Rep. 130; *Morawetz, Private Corp.*, § 137.

or recording fees, in proportion to the capitalization of the corporation.

This is usually termed, "Incorporation," or "Organization" tax, which is simply the amount the state exacts from a corporation for permission to carry on business within the state, and usually applies to both foreign and domestic corporations alike. It has been suggested that this tax has also for its purpose, the discouragement of wild cat corporations, believing that the incorporation fee will, in a measure, at least, prevent overcapitalization of companies.⁹ That a state has the right to impose such a tax is now generally regarded as settled law.¹⁰

Various schemes to evade the payment of this tax have been devised or attempted, the most prevalent one being to organize a corporation having a large capitalization in some state wherein the graded tax is not imposed, then to organize a corporation with a smaller capitalization under the laws of the state wherein the corporation intends to operate, both corporations having the same identical name. The smaller corporation, or the corporation organized under the laws of the state wherein the business is to be transacted, then acquires title to the property necessary for the corporate business, and issues the entire capital stock of such corporation in payment thereof. This stock, of course, all goes into the hands of the incorporators, or the promoter of the scheme. The larger corporation then undertakes to purchase from its holders the entire capital stock of the smaller corporation, and by various manipulations, uses the entire capital stock of the

⁹ *Jones v. Aspen Hdw. Co.*, 21 Col. 263, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. Rep. 220.

¹⁰ *Ashley v. Ryan*, 49 Ohio St. 504, 31 N. E. 721; *Gordon v. App. Tax Court*, 44 U. S. 133, 11 L. Ed. 529; *Home Ins. Co. v. People of the State of N. Y.*, 134 U. S. 594, 33 L. Ed. 1025; *People v. Rose*, 210 Ill. 582, 71 N. E. 580.

larger corporation for the stock of the smaller corporation, which stock in turn falls into the hands of the incorporators, or the promoters of the scheme. They, in turn, donate back to the treasury of the larger corporation such number of shares as is deemed by them to be necessary to provide a working capital for such corporation. This stock is commonly called treasury stock, and after being donated to the corporation and placed in its treasury is then disposed of by the corporation to the general investing public. Often the investor will be unadvised as to the complicated nature of the scheme, and assumes that he is purchasing stock in the corporation that actually owns the properties, when as a matter of fact, the corporation in which he has purchased the stock, simply owns the entire capital stock of the corporation that owns the properties.

This plan is very complicated and unsafe, to say the least, and has many ear marks of wild-catting. Its legality is very doubtful in *quo warranto* proceedings by the state, by reason of the fraud practiced upon the state, to evade its laws.¹¹ While this scheme and plan often saves the promoters of a corporation a little money, at the time of its organization, it is never under any circumstances advisable to undertake to carry it out.

§ 36. **Sundry requirements.**—The statutes of Oregon, Utah, and many other states require an affidavit to be filed as to the actual amount of stock subscribed. In South Dakota, an anti-trust affidavit is required. Some states, among them Arizona and Iowa, provide for the publication in some newspaper published in the county in which the principal place of business of the corporation is located, of a copy of the articles of incorpora-

¹¹ See 10 Cyc. 235.

tion, or the substance thereof, for a certain designated period of time. All of these provisions having been properly complied with, and an authenticated copy of the articles of incorporation, in the states of Arizona, Colorado, California, Idaho, Montana, Utah, Washington, and some few other states, must be filed in the office of the recording officer of the county wherein the principal place of business is located. This having been done, the organization meeting now may be called and held, and the acceptance of the charter at such meeting will be the next step toward completing the organization.

§ 37. **Effect of failure to comply with statute.**—Before leaving the question of organization, it is proper to note that a corporation is in itself, a franchise, and to acquire this franchise, under the general law, the prescribed statutory provisions must be complied with; that is, the state in effect says, that to certain persons complying with certain statutes and doing certain things, will be granted a franchise for certain purposes. There must be at least a substantial compliance with each and every provision of the statute of the state wherein incorporation is sought.

“There is a broad distinction,” says the supreme court of Colorado, “between those acts made necessary by the statute as a prerequisite to the exercise of corporate powers, and those acts required of individuals seeking incorporation, but not made prerequisite to the exercise of such powers. In respect to the former, any material omission will be fatal to the existence of the corporation, and may be taken advantage of, collaterally in any form in which the fact of incorporation can properly be called into question. In respect to the latter, the corporation is responsible only to the government in a direct proceeding to forfeit the char-

ter.”¹² Thus, failure of the incorporators to sign the articles of incorporation has been held fatal to legal corporate existence, especially a *de jure* existence.¹³ So, too, failure to state within the articles of incorporation, the name of the proposed corporation has been held fatal;¹⁴ and failure to state clearly and properly, the objects and purposes for which the corporation was organized.¹⁵ So, also, as to the residence of the incorporators;¹⁶ and also failure to state the number and names of the directors.¹⁷

Where the statute requires five or more persons to sign and acknowledge the articles of incorporation, and such articles are signed by five, but acknowledged by only four, it has been held a fatal defect in proceedings against the corporation by *quo warranto*;¹⁸ and failure to state the number and names of the directors has also been held to be fatal to the existence of the corporation;¹⁹ or failure to give the location of the principal place of business of the corporation;²⁰ or omission to state the amount of capital stock of the corporation.²¹

The failure to file the articles of incorporation with the proper recording officer specified by law has been held in a number of courts to be fatal to even *de facto*

¹² *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. Rep. 220.

¹³ *People v. Montecito Co.*, 97 Cal. 276, 32 Pac. 236, 33 Am. St. Rep. 172; *Corey v. Morrill*, 61 Vt. 598, 17 Atl. 840; *State v. Critchett*, 37 Minn. 13.

¹⁴ *Rhodes v. Piper*, 40 Ind. 369; *Piper v. Rhodes*, 30 Ind. 309.

¹⁵ *State v. Central Ohio Relief Ass'n*, 29 Ohio St. 399; *State v. Beck*, 81 Ind. 500.

¹⁶ *Busenbach v. Attica Co.*, 43 Ind. 265.

¹⁷ *Reed v. Richmond, etc. Co.*, 50 Ind. 342.

¹⁸ *People v. Montecito Co.*, 97 Cal. 276, 32 Pac. 236, 33 Am. St. Rep. 172.

¹⁹ *Reed v. Richmond, etc. Co.*, 50 Ind. 342.

²⁰ *Clegg v. Hamilton, etc. Co.*, 61 Iowa, 121, 15 N. W. 865.

²¹ *State v. Shelbyville Co.*, 41 Ind. 151.

existence.²² Failure to publish the articles of incorporation, as the law requires is fatal to a *de jure* existence.²³ Failure to comply with the incorporating statutes sufficient to bring into existence a *de facto* corporation will often be the cause of disastrous results, not only to the incorporators, but to its stockholders as well. Thus many authorities now hold that where individuals have attempted to organize a corporation, but have failed to comply with the requirements of the statute of the state wherein incorporation is sought, they are individually liable as partners. An examination of the authorities upon this question will show that the whole question is clouded with confusion and irreconcilable conflict, with the authorities almost evenly divided. However, as there are a number of courts that hold, that, a creditor of a corporation, who is seeking to enforce payment of his debt may ignore the existence of the corporation and proceed against the supposed stockholders, as partners, by proving that the prescribed method of becoming a corporation, has not been complied with,²⁴ it can readily be seen that

²² *Abbott v. Omaha Smelting Co.*, 4 Neb. 416; *Capps v. Hasting Prospecting Co.*, 40 Neb. 470, 58 N. W. 956, 28 L. R. A. 259, 42 Am. St. Rep. 677; *McLennan v. Hopkins*, 2 Kan. App. 260, 41 Pac. 1061; *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 52 Am. St. Rep. 220, 29 L. R. A. 143; *Md. Tube, etc. Wks. v. West End Imp. Co.*, 87 Md. 207, 39 Atl. 620, 39 L. R. A. 810; *Bash v. Culver Gold Min. Co.*, 7 Wash. 122, 34 Pac. 462; *Martin v. Deetz*, 102 Cal. 55, 36 Pac. 368, 41 Am. St. Rep. 151; *Bergeron v. Hobbs*, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85; *Humphries v. Mooney*, 5 Colo. 282.

²³ *Elsfeld v. Kenworth*, 50 Iowa, 389; *Clegg v. Hamilton, etc. Co.*, 61 Iowa, 121, 15 N. W. 865.

²⁴ *Taylor v. Branham*, 35 Fla. 297, 17 South. 552, 39 L. R. A. 362, 48 Am. St. Rep. 249; *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. Rep. 220; *Garnett v. Richardson*, 35 Ark. 144; *Pettis v. Atkins*, 60 Ill. 454; *Bigelow v. Gregory*, 73 Ill. 197; *Coleman v. Coleman*, 78 Ind. 344; *Johnson v. Corser*, 34 Minn. 355, 25 N. W. 799; *Hurt v. Salisbury*, 55 Mo. 310; *Ferris v.*

no chances should be taken on an imperfect organization.

Mr. Cook in his work on corporations says, "There are many cases to the effect that a corporate creditor, seeking to enforce the payment of his debt may, however, ignore the existence of the corporation and may proceed against the supposed stockholders as partners, by proving that the prescribed method of becoming incorporated was not complied with by the company in question."²⁵ He is not estopped from so doing, since he is not repudiating a contract, but enforcing it.

The supreme court of Colorado, in *Jones v. Aspen Hdwe. Co.* takes the view that, a company, intended to be a corporation, but which has failed to comply with the statute requiring it to file its certificate of incorporation with the secretary of state, and to pay a fee therefor, is neither a *de jure* nor *de facto* corporation, but simply a voluntary association of individuals in the nature of a co-partnership.²⁶ So, too, the supreme court of Florida, in *Duke v. Taylor*, holds that a corporation creditor may ignore the existence of the corporation and proceed against the supposed stockholders as partners, by proving that the prescribed method of becoming incorporated has not been complied with.²⁷ On the other hand, a number of courts attack this rule of law, with much vigor and very strong language, and

Thaw, 72 Mo. 446; *Martin v. Fewell*, 79 Mo. 401; *Abbott v. Omaha, etc. Smelting Co.*, 4 Neb. 416; *Kaiser v. Lawrence Sav. Bank*, 56 Iowa, 104, 8 N. W. 772, 41 Am. Rep. 85; *McLennan v. Hopkins*, 2 Kan. App. 260, 41 Pac. 1061; *Walton v. Oliver*, 49 Kan. 107, 33 Am. St. Rep. 355, 30 Pac. 172; *Cincinnati, etc. Co. v. Bate*, 96 Ky. 356, 49 Am. St. Rep. 300, 26 S. W. 538; *Whipple v. Parker*, 29 Mich. 369; *Bergeron v. Hobbs*, 96 Wis. 641, 65 Am. St. Rep. 85, 71 N. W. 1056; *Cases in 26 Am. & Eng. (2nd. Ed.)* pg. 1028.

²⁵ Cook on Corporations, § 233.

²⁶ *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. Rep. 220.

²⁷ *Duke v. Taylor*, 37 Fla. 64, 19 South. 172, 31 L. R. A. 484, 53 Am. St. Rep. 232.

lay down the proposition that, in the absence of a fraudulent intent, there can be no such thing as partnership liability attached to stockholders, holding themselves out as a corporation, when in fact they are not such.

Bigelow, J., delivering the opinion in *Fay v. Noble*,²⁸ says, "We are not aware of any authority to warrant the instruction that in consequence of an omission to comply with the requisitions of law, in the organization of a corporation, by which its proceedings are rendered void, persons who had subscribed for and taken stock in the company thereby become partners. The doctrine seems to us to be quite novel and somewhat startling. Surely, it cannot be, in the absence of all fraudulent intent, that such a legal result follows as to fasten on parties involuntarily to such a cause, the enlarged liability of co-partners—a liability neither contemplated nor assented to by them. The very statement of the proposition carries with it sufficient refutation. No such result can follow, unless a principle of law be established, founded on no authority, and required by no public exigency. Corporations are known and recognized legal entities, with rights and powers clearly defined and understood, and wholly distinct and different from those of individuals and co-partners."

In *Gartside Coal Co. v. Maxwell*, Mr. Justice Brewer says, "I think the true rule is this: that where persons knowingly and fraudulently assume a corporate existence, or pretend to have a corporate existence, they can be held liable as individuals; but where they are acting in good faith, and suppose that they are legally incorporated,—that they are stockholders in a valid corporation,—and where the corporation assumes to transact business for a series of years, and the assumed corporate existence is not challenged by the state, then

²⁸ *Fay v. Noble*, 7 Cush. 192.

they cannot be held liable, as individuals, as members of the corporation." ²⁹

The supreme court of the United States has said persons cannot be made to assume the relation of partners as between themselves, when their purpose is, that no partnership shall exist.³⁰ The authorities generally cited to sustain this rule are many.³¹ As will be seen more fully hereinafter, the directors and officers of the corporation, representing to the general investing public, or parties dealing with such corporation, that there is a corporate existence, when as a matter of fact there is none, either *de jure* or *de facto*, they will be personally liable to such parties as partners, in all contracts made for and in behalf of the supposed corporation.³² From an examination of all of the above authorities and many others that might be cited upon the question of partnership, it must be said that the question is clouded with confusion and uncertainty. It would seem upon principle, and possibly, upon authority, that if the organization is not at least a *de facto*

²⁹ *Gartside Coal Co. v. Maxwell*, 22 Fed. 197.

³⁰ *London Assurance Corp. v. Drennen*, 116 U. S. 461.

³¹ *Gartside Coal Co. v. Maxwell*, 22 Fed. 197; *Whitney v. Wyman*, 101 U. S. 392, 25 L. Ed. 1050; *Planters, etc. Bank v. Padgett*, 69 Ga. 159; *Stafford Natl. Bank v. Palmer*, 47 Conn. 443; *Ward v. Brigham*, 127 Mass. 24; *Jessup v. Carnegie*, 80 N. Y. 441, 36 Am. Rep. 643; *Blanchard v. Kaull*, 44 Cal. 440; *Sneider's Sons Co. v. Troy*, 91 Ala. 224, 8 South. 658, 24 Am. St. Rep. 887; 11 L. R. A. 525; *Cory v. Lee*, 93 Ala. 468, 8 South. 694; *Mokelumme Hill M. Co. v. Woodbury*, 14 Cal. 265, 73 Am. Dec. 658; *Humphries v. Mooney*, 5 Colo. 282; *Fay v. Noble*, 7 Cush. 188; *Trowbridge v. Scudder*, 11 Cush. 83; *First Natl. of Salem v. Almy*, 117 Mass. 476; *Mer. & Mnf. Bank v. Stone*, 38 Mich. 779; *Stout v. Zulick*, 48 N. J. L. 599, 7 Atl. 362; *Vanneman v. Young*, 52 N. J. L. 403, 20 Atl. 53; *Method. Church v. Pickett*, 19 N. Y. 482; *American Salt Co. v. Heidenheimer*, 80 Texas, 344, 15 S. W. 1038, 26 Am. St. Rep. 743; *Owensboro Wagon Co. v. Bliss*, 132 Ala. 253, 90 Am. St. Rep. 907, 31 South. 81; *Duke v. Taylor*, 37 Fla. 64, 53 Am. St. Rep. 232, 19 South. 172, 31 L. R. A. 484; *Clauson v. Head*, 110 Wis. 405, 84 Am. St. Rep. 933, 85 N. W. 1028.

³² *Walton v. Oliver*, 49 Kan. 107, 30 Pac. 172, 33 Am. St. Rep. 355; *Fay v. Noble*, 7 Cush. 188.

organization, then the members thereof are nothing more nor less than a voluntary association with partnership liability, or at least, individual liability. But where such requirements have been complied with as to bring into existence a *de facto* corporation, then of course, they are neither liable, upon the theory of partnership liability, nor individual liability; because there is a corporation in existence whose legality can be questioned only by the state in *quo warranto* proceedings, and it is to all intents and purposes, except against the state, a legal and existing organization. In other words, it seems to us that the dividing line of inquiry should be, whether or not a company intended as a corporation has a *de facto* existence, and if not, then the members thereof should be considered, in law, as partners, or, at least, individually liable for the debts and obligations of the supposed corporation.

This seems to us to be the better and sounder law, notwithstanding the many able opinions to the contrary. However, it is to be noted in many of the cases cited, that a majority of them find facts sufficient to clearly indicate that the corporation had a *de facto* existence. All the cases go to the extent of holding that where there is a *de facto* corporation, its members, or stockholders, cannot be held as partners, and the corporation can only be questioned and attacked by the state in a direct proceeding.

§ 38. **Estoppel to deny corporate existence.**—Closely related to the question above discussed is the question of permitting the corporate existence to be attacked in a collateral proceeding, that is, in some proceeding other than a direct attack upon the existence of the corporation. Innumerable cases might be cited on the general proposition of law, that the legality of the existence of the corporation cannot be attacked in collateral proceedings. Upon that exact question, the law is set-

tled absolutely. Aside from the innumerable decisions a number of states now have statutes governing this question.³³

So too, the law is well and generally settled that a person contracting with a corporation is estopped to deny the corporate existence of such corporation. It would be but an unnecessary waste of time and space to cite the many authorities establishing this rule of law, for such is the law, as well established by innumerable decisions.³⁴ However, to these two general and well established rules of law, there are exceptions sustained by authority. On principle, it would seem that both of these questions should be determined by whether or not the corporation has at least a *de facto* existence. If the intended corporation has, in law, a *de facto* existence, then a person dealing with it cannot, and is not permitted, to deny the existence of such corporation, or set up any alleged defect in its organization, or capacity to contract, but if the organization has neither a *de facto*, nor *de jure* existence, in law, then it is not a corporation, and the doctrine of estoppel should have no application.

That is, if a person deal with an association, assuming it to be a corporation, when in truth and in fact, it is not a corporation, neither *de jure* nor *de facto*, then the general rule announced should have no application, and such person should be permitted to attack the legality of the organization, even in a collateral proceeding. To otherwise hold is but to hold that corporations can be created out of a voluntary association of individuals, by the doctrine of estoppel, and if this is to be permitted by the courts, then all the general incorporation acts are with one sweep nullified and held for naught, except preserving to the state the right to inquire into

³³ 8 Am. & Eng. Enc. of Law, 2nd. Ed. 754; 1 Supp. 300.

³⁴ See above citation.

its existence, by *quo warranto*, which always will be found very unsatisfactory and of little benefit.

Even after the question has been settled by the state in a *quo warranto* proceeding, the court with equal logic and consistency could hold that such corporation was still protected, by refusing to permit the question of its corporate existence to be disputed, or raised. Too much latitude in this direction should never be indulged by the courts, for it simply encourages a laxity in organizing corporations, and encourages promoters and organizers of corporations to disregard the general provisions of the law.

A number of courts now hold that one dealing with a corporation is not estopped from denying its status of legal existence unless the corporation has at least a *de facto* existence, which as we view the question, notwithstanding the authorities to the contrary is the better and sounder law.³⁵ From what already has been said, it is very apparent that it is necessary to determine, in a general way, what constitutes a *de facto* corporation, which question is discussed, in a general way, in another chapter.

³⁵ *Duke v. Taylor*, 37 Fla. 64, 19 South. 172, 31 L. R. A. 484, 53 Am. St. Rep. 232; *Harriman v. Southam*, 16 Ind. 190; *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 29 L. R. A. 143, 52 Am. St. Rep. 220; *Snyder v. Studebaker*, 19 Ind. 462, 81 Am. Dec. 413; *Ind., etc. Co. v. Ogle*, 22 Ind. App. 593, 54 N. E. 407, 72 Am. St. Rep. 326; *Williams v. Hewitt*, 47 La. Ann. 1076, 17 South. 496, 49 Am. St. Rep. 394; *Empire Mills v. Alston, etc. Co.*, 15 S. W. 505, 12 L. R. A. 366; *McGrew v. City Produce, etc.*, 85 Tenn. 572, 4 S. W. 38, 4 Am. St. Rep. 771; *Brandenstein v. Hoke*, 101 Cal. 131, 35 Pac. 562; *Clark v. Am., etc. Co.*, 165 Ind. 213, 73 N. E. 1083, 112 Am. St. Rep. 217; *Marshall v. Keach*, 227 Ill. 35, 81 N. E. 29, 118 Am. St. Rep. 247.

CHAPTER VII.

ORGANIZATION MEETING.

- § 39. How called.
- 40. Where held.
- 41. Contents of waiver and consent.
- 42. Transaction of business.
- 43. Meeting of the board of directors.

§ 39. **How called.**—We now come to the third and last step in the completion of the organization of the corporation, which is, the organization meeting. The stockholders have no function in the direct management and control of the affairs of the corporation, but they are nevertheless the real power of the organization. They elect the board of directors, and usually dictate the policy of the corporation. In them is vested the power of dissolving or continuing the corporate organization. They function however only as stockholders in lawful meeting assembled.

The first stockholders' or organization meeting, as it is called, is of great importance, and should be called and held in strict compliance with the statute of the state under which the corporation is created. Statutes now generally provide that the first meeting may be called by notice, signed by one or more of the persons named as trustees in the articles of incorporation. However, as these statutes are now regarded as merely directory,¹ it is believed that the simpler and better method of calling and holding this meeting is by waiver and consent.

§ 40. **Where held.**—The organization meeting must be held within the jurisdiction of the state under whose laws the corporation is created. This is mandatory

¹ *Braintree v. Braintree*, 146 Mass. 482, 16 N. E. 420.

and any attempt to hold the organization meeting outside of the jurisdiction of such state, will be void.²

§ 41. **Contents of waiver and consent.**—The waiver and consent should be signed by all of the incorporators, the stockholders, if any there are, and all the subscribers to the capital stock, and after being so signed, should contain the certificate of the secretary, certifying that it contains a full and complete list of the stockholders, incorporators and all the subscribers to the capital stock of the company.

Care must always be exercised to see to it that it contains an enumeration of all the business to be transacted at the meeting, giving the time and the place of holding the meeting, as well as the consent "To the transaction of any and all business pertaining, in any way, to the organization, interests, or welfare of the company, together with any and all business that may properly come before the meeting." It is to be noted that this plan eliminates the usual statutory notice. The law is believed to be well settled that where all of the persons interested sign the written waiver and consent, or where all are present and take part in the meeting, that no formal call is necessary. In other words, the formal call is waived.

§ 42. **Transaction of business.**—It is advisable that this meeting be in charge of the attorney organizing the corporation. At the time and place named and designated in the waiver and notice, the interested persons will meet in formal meeting, call the meeting to order, appoint one of their number as chairman, and

² *Duke v. Taylor*, 37 Fla. 64, 19 South. 172, 31 L. R. A. 482, 53 Am. St. Rep. 232; *Smith v. Silver Min. Co.*, 64 Md. 85, 20 Atl. 1032, 54 Am. Rep. 760; *Miller v. Ewer*, 27 Me. 509, 46 Am. Dec. 619; *Mitchell v. Vt. Copper Co.*, 67 N. Y. 280; *Taylor v. Branham*, 35 Fla. 297, 17 South. 552, 39 L. R. A. 362, 48 Am. St. Rep. 249; *Camp v. Byrne*, 41 Mo. 525.

another as secretary. This being done, the chairman should assume control of the meeting and briefly outline the purpose for which the meeting has been called. The secretary must keep careful and correct minutes of the proceedings of the meeting, and see to it that the proceedings of that particular meeting are recorded, duly signed and certified to, by the chairman and secretary, separate and distinct from all other proceedings.

The first duty of the secretary is to read the waiver and consent, and as soon as read, a motion will be in order accepting the same, and ordering the secretary to record it among the permanent records of the corporation. The meeting will now be open and ready for the transaction of business.

The first business to be transacted will be the acceptance of the corporate franchise. To do this, the secretary should first read the certificate of incorporation, or the certified copy thereof, issued by the secretary of state, or the proper recording officer. This certificate should, on motion be accepted and the secretary be instructed to record the same among the permanent records of the corporation. The corporation, immediately upon the acceptance of the charter, will be complete and ready to do business in its own name. That is, the corporation will have been created, as the law requires.

The first thing that is necessary after the organization of the corporation is complete, is the adoption of a set of by-laws. Of course, the by-laws will have been prepared by an attorney and examined by the incorporators, prior to this meeting, who will see to it that they contain everything necessary for the government of the corporation, its directors and stockholders, as prescribed within the limits of the governing statute of the state under whose laws the corporation has been created; setting forth the powers and duties of the di-

rectors and officers, and affording proper protection to the stockholders. Hence, the only thing that is necessary at this meeting will be their formal adoption. This is usually done by reading them section by section, and if there is no objection to any of the sections or articles read, they are adopted as a whole.

We are quite familiar with the haphazard manner in which companies often adopt by-laws, which is nothing more nor less than adoption by acquiescence. That is, the incorporators at this meeting, having examined the by-laws, conclude to their own satisfaction that they are sufficient for the government of the corporation, simply permit the records to show that they have been adopted in the regular way. There is no objection to this where the stockholders, or the subscribers to the capital stock of the corporation are familiar with the contents of the by-laws, and where the incorporators are present at the meeting and consent to their adoption, otherwise there is always serious objection to carelessly adopting by-laws, and it never should be indulged by a corporation.

After the by-laws have been adopted, the secretary should be ordered to record them among the permanent records of the corporation, in a legible hand-writing. It is never advisable to permit the by-laws of the corporation to be recorded in a loose-leaf minute book, written out on a typewriter, as this affords too much opportunity for frauds to be practiced upon the stockholders, by substituting and changing the by-laws.

The next step to be taken, is the consideration of purchasing property and issuing the entire capital stock of the corporation in payment therefor. We have heretofore suggested that it is a familiar practice in the organization of corporations to purchase property and issue in payment therefor, the entire capitalization of the corporation, with the understanding that a part of

the stock issued in consideration of this property shall be donated and returned to the treasury of the corporation for the purpose of giving the corporation a working capital. We already have suggested that the business affairs of the corporation are managed and controlled by the directors. Nevertheless, it is highly important that the consent and authorization, or ratification of all of the stockholders and the subscribers to the capital stock should be had to this particular transaction.

The purpose of this transaction is two-fold: first, to provide the corporation with a working capital, and second, to make the stock of the corporation full paid, under the law, and thus protect future stockholders in actions for unpaid subscriptions. There also is an ulterior reason for this method of organizing corporations; and it is found in the fact that usually the property to be conveyed to the corporation is either owned by the promoter of the corporation, or possibly by one or more of its trustees, or controlled by an option by one or more of these parties. The promoter or trustees, thus having an interest in the transaction by their ownership of the property would not be competent to contract for the corporation without the consent of the stockholders and subscribers to the capital stock and if such a contract were made without such authority or ratification, it might, in after years, be annulled or set aside by the corporation, or any of its dissenting or objecting stockholders. The question is fully discussed elsewhere in this work.

On the other hand, as many courts now hold that subsequent purchasers of stock cannot complain of transactions, or frauds, of the directors or promoters of a corporation, care is always taken to limit the membership to persons under the direct control of the promoter or directors of the corporation, so that the records of

the corporation will show that all of the stockholders or subscribers to stock, at the time of the transaction, took part in the transaction and consented to and voted for the same. Thus, in after years, should stockholders undertake to recover secret profits of the promoter, or rescind the contract by reason of the fact that the directors had a personal interest in the transaction, they promptly would be met with the defence that all the stockholders had consented to the transaction, and that they, as subsequent purchasers of stock, could not complain.

This is the important reason why the organization meeting should be called and held in strict compliance with the statute of the state wherein the corporation is created, as very often, in after years, this meeting for this identical reason will be assailed from every conceivable standpoint.

The offer to transfer the property to the corporation for its entire capital stock should be in writing, properly signed by the owner or trustee of the property, giving a full, complete and accurate description of the property, and setting forth the terms and conditions upon which the conveyance will be made. This offer should be read, considered and acted upon. Of course it is usually accepted and ordered recorded upon the permanent records of the corporation. The motion, or resolution, accepting the offer should instruct the directors to accept the offer and a duplicate of the offer filed with the records of the directors, so that it can readily be identified in after years as being the same property. If the property is owned by the promoter of the corporation, then the records should show that he is the owner of such property, as it always is dangerous to conceal that fact.

In Arizona, Idaho, Montana, Washington and many other states, the board of trustees who manage the con-

cerns of the corporation for such length of time as may be by law designated, is provided for in the articles of incorporation. Under the laws of those states, the board of directors need not be chosen at the organization meeting, but may be left for the first annual meeting of the stockholders, which in that event must be held within the time prescribed by statute. The statutes of the several states must be consulted in this regard, and where the law requires the board of directors to be elected at the organization meeting, they will of course be elected. They will be elected and take charge of the business affairs of the corporation from that time on.

In later years, the practice has become quite prevalent, of having the attorney organizing the company to prepare the minutes of the organization meeting in advance of the meeting; the facts and data for such meeting being supplied to him by the promoter, or the incorporators of the company. There can be no serious objection to this practice. It has the advantage of simplifying the work of this, the most important meeting of the corporation, and the merit of having a full and complete set of records, carefully and properly prepared. The minutes should be signed by the chairman and secretary, and certified by them as being a full, true and correct transcript of the proceedings had and done, and the business transacted at the meeting. It is never advisable to permit duplicate copies of the minutes of this meeting to be made. The organization of the corporation now having been completed, attention should be turned to the methods of carrying out the objects and purposes for which the corporation was created. The work done up to this period is important in that it lays the foundation for the carrying to a successful issue, the scheme and plan proposed by the promoter and the incorporators of the concern.

It now depends upon the ability, the honesty, and integrity of the board of directors, assisted in a measure by the stockholders, to promote the enterprise to a successful issue. There is merit in the corporate system when the men in charge of its organization control the business affairs after it has been organized, in the interests of the stockholders and the organization, and not in their individual interests. Generally speaking, unless men of integrity, honesty and ability can be placed at the head of the corporation, to manage and conduct its affairs, and see that its business is properly prosecuted, there is little merit in the corporate system. Much of the criticism that has been heaped upon corporations of late years, has been caused by pirates, who feast upon the ignorance and credulity of people who invest in corporations that are managed, conducted and controlled for the sole and only purpose of furnishing employment, fees and grafts for the men at the head of the concern.

§ 43. Meeting of the board of directors.—Immediately upon the adjournment of the organization meeting, the board of directors or trustees of the corporation should be called together. The method of calling the board of directors together must depend upon circumstances. The by-laws will have been adopted by the stockholders before this meeting is called to order, hence it is necessary that the provisions of the by-laws be complied with in calling and holding directors' meetings.

If the by-laws provide that the directors shall meet immediately upon the adjournment of the organization meeting, then of course the record should be prepared accordingly, but if the by-laws do not make such provision, then it is believed to be necessary that a waiver and consent be signed by all of the directors and trus-

tees, and filed among the permanent records of the corporation. This waiver and consent should contain, as the waiver and consent of the stockholders' meeting, the time and place of holding the meeting, and the business to be transacted, and the same plan and procedure outlined for the organization meeting should be followed by the directors. That is, upon assembling, the meeting should be called to order by one of the directors, after which, one of their number should be chosen as chairman, and one of the number as secretary. This being done, the chairman should assume control of the meeting and briefly outline the business to be transacted. The secretary will keep careful and correct minutes of the proceedings of the meeting, and see to it that they are properly recorded.

The first duty of the secretary is to read the waiver and consent, and as soon as read, a motion will be in order accepting the same, and ordering the secretary to record it among the permanent records of the corporation. A roll call should then be had, and if a majority of the directors of the corporation is present, the meeting will be ready to proceed with the business before it. Usually the first thing will be the election of the officers of the corporation. These officers will have been provided for by the by-laws; also the procedure of the election and qualification and tenure of office. The record in all cases should show a careful compliance with the by-laws, and where the by-laws provide that the officers shall be elected by ballot, the record should show compliance with that provision. Immediately after the organization shall have taken place, the newly elected officers will subscribe to the usual oath of office, and then take charge of the meeting if present, but if absent, the record should so state, and the temporary officers retain charge of the meeting.

The corporation now having completed its corporate

existence, the directors having been provided for, the officers elected, everything is in readiness to begin carrying out the objects and purposes of the corporation. Too much stress cannot be laid upon the fact that the board of directors are the chosen guardians of the property of the stockholders, and are in duty bound to act in the utmost good faith at all times, to use a reasonable amount of diligence in the discharge of their duties, as they have duties to perform, other than passing a few minor resolutions, drawing their salaries, and ratifying the acts of their officers.

The general affairs of the corporation should be discussed, and the general plan of operation outlined. They should begin a system from the start of authorizing their officers to do certain things, and not drift into the plan of leaving their officers to do as they please, and afterwards ratifying their acts, either expressly or by acquiescence. The selection and adoption of the form of the stock certificate, stock book and seal, will be done at this meeting. The secretary should be instructed and authorized to purchase the necessary corporate books, such as the stock ledger, cash book, address book, and in fact, all necessary books and stationery needed by the corporation in the prosecution of its business. The treasurer should be authorized to pay the expenses incidental to the incorporation of the company. The proper officer should be instructed and authorized to rent suitable and proper offices for the corporation.

After the disposition of all the foregoing matters, the proposition of exchanging stock for property should be taken up. The proposition of bringing this before the directors after having been authorized and passed upon by the stockholders, is an extraordinary precaution. The resolution passed by the stockholders should be before the meeting, and after noting this res-

olution, a like resolution should be passed, authorizing and instructing the officers to receive the necessary transfers of the property from the owner, and to issue to him, or to his order, stock in accordance with the terms of the offer, and the resolutions accepting the offer.

Care should always be taken in the issuing of the entire capital stock of the corporation for property, to reserve from such sale, the stock subscribed by the trustees and officers, as the sale of the entire capital stock would include the subscription of the directors and trustees, which might *ipso facto*, deprive them of their office as directors and nullify the entire proceedings. It will be found advisable not to adjourn the meeting *sine die*, but to adjourn to a certain day, say from three to ten days, as it is necessary for the board of directors to meet very often during the early period of organization.

The practice of intrusting everything to the officers of the corporation is a very dangerous one, and should never be indulged in. As we already have suggested, the management and control of the business affairs of the corporation is by law intrusted to the board of directors, who stand in a fiduciary relation to the stockholders, and when one voluntarily takes the position of director of a corporation, good faith, exact justice, and public policy unite in requiring of him at least, ordinary prudence, care and skill in the discharge of his duties, and the utmost good faith in his business transactions for the corporation. Unless this is done, he is liable to the corporation for any damages occasioned by his neglect, and he cannot shield himself from liability, resulting from committing the management of the corporation to its officers, on the ground that he believed such officers honest, faithful and competent, when such officers misappropriate or dissipate

the funds of the corporation. It is their duty to be informed as to what is being done with the corporate assets.³ In addition to what already has been said, the salaries of the officers and employes of the corporation should be fixed by the board of directors at this meeting. The directors cannot fix their own salaries, as this must be done either in the by-laws, or be authorized by the stockholders, and any attempt to fix their own salaries would simply be a nullity and might afterwards be collected by the corporation from them, if they are paid.

³ *Williams v. McKay*, 40 N. J. E. 189, 53 Am. Rep. 775; *Hun v. Cary*, 82 N. Y. 65, 37 Am. Rep. 546; *Ackerman v. Halsey*, 37 N. J. E. 356; *Delano v. Case*, 121 Ill. 247, 12 N. E. 676, 2 Am. St. Rep. 81; *Bank v. Hill*, 56 Me. 385, 96 Am. Dec. 470; *Fletcher v. Eagle*, 74 Ark. 585, 86 S. W. 810, 109 Am. St. Rep. 100; *Marshall v. Farmers', etc. Savings Bank*, 85 Va. 676, 8 S. E. 586, 2 L. R. A. 534, 17 Am. St. Rep. 84; *Land Equity Co. of Ireland v. Lord Fermoy*, L. R. 5, Chapp. 763.

CHAPTER VIII.

IN WHAT STATE SHOULD INCORPORATION BE HAD.

§ 44. Generally.

45. Where all business is transacted in a different state.

46. Making stock full paid.

47. Liabilities.

48. Cost of incorporating.

§ 44. Generally.—A question of some importance that will often confront the organizers of a corporation is to determine under the laws of what state incorporation should be had. It is to be remembered at the outset of this question that there is a wide range of difference in the laws of the different states, both in the initial cost and the expenses after incorporation is had. Even upon the question of taxation, some states are more liberal than others. Since the adoption of the liberal and comprehensive incorporation laws by the State of New Jersey, other states have followed its example and enacted, to a certain extent, similar laws, some of which however are more or less crude and unsafe to organize under. Indeed some of the states, seeing in such laws a liberal source of revenue to the state, not only enacted laws that made their state an inviting field for incorporation, but put themselves forward in the open market, bidding for business. These laws in turn, brought the incorporating agencies into existence, whose business is to organize and act as resident agent for persons outside of their state, who intend to carry on all of the business of the corporation in some other state than that in which they are organized. These incorporating agencies naturally interested themselves in liberalizing and popularizing the incorporation laws of their respective states,

until, to a certain extent, almost any kind of a law desired can be found under which to incorporate.

The plan of incorporating under the laws of one state and carrying on all of the business in another was first found to be difficult and inconvenient. To eliminate the inconvenience, laws were enacted permitting the directors of the corporation to meet outside of the state of incorporation. This move eliminated some inconveniences which had theretofore existed, and gave encouragement to the next and important move of enacting laws permitting the stockholders of the corporation to hold their annual meetings outside of the state of incorporation. That makes it very convenient and inexpensive for corporations to organize under the laws of one state, and pay little or no attention to the incorporation, in so far as that state is concerned, after the incorporation is completed. We have no criticism to offer to the practice of promoters selecting the state whose laws are most liberal and comprehensive to the plans and schemes of their corporation, for, if it is right for legislatures to pass liberal laws and make their state an inviting field for incorporation, then it is right for promoters to seek that field and organize under their laws. The next step will doubtless be laws permitting the organization meeting to be held outside of the state of incorporation, so that all that will be necessary is for the promoters desiring to organize a corporation to send to some incorporating agency, articles of incorporation for filing, and never after to be compelled to look in the direction of that state, except of course, to maintain a resident agent and pay him his fees, and file such reports as the statutes may require. Such laws, however, can hardly commend themselves to the judgment of the general public, and, we cannot help remarking that a corporation with large business interests and valuable property in its posses-

sion, would hardly be safe in organizing under the cheap, loose, and unstable corporation laws that exist in some of the Western states.

§ 45. Where all business is transacted in a different state.—The general scheme of organizing under the laws of one state and carrying on all of the corporation's business in another, first met with much objection in the courts. Even New Jersey, in an early case, refused to recognize the validity of such corporations, and in the course of its opinion that court said, "Such corporations cannot be recognized by any court in New Jersey as a legally constituted corporation, nor be dealt with as such. If it can be, what need is there for any general or special law in our state."¹ However, the legality of such corporations is now recognized by the undisputed weight of authority. The New York Court of Appeals in *Merrick v. Van Santvoord*,² in a very elaborate opinion, among other things says, "Hitherto corporate enterprise has not been trammelled by unfriendly legislation. No jealousy of competition or rivalry of adverse interests has been permitted to convert state lines into barriers of obstruction to the free course of general commerce. Its avenues have been open to all.

"In this country our material interests are so interwoven that the union of the states is due, in its continuance, if not in its origin, as much to commercial as to political necessity. The citizens of each claim a birthright in the advantages and resources of all. They demand from their local authorities such facilities as the law-making power can afford in the employment of

¹ *Hill v. Beach*, 12 N. J. E. 31; see also *Montgomery v. Forbes*, 148 Mass. 249, 19 N. E. 342. Such corporations are called "tramp corporations." *State v. Georgia Co.*, 112 N. C. 34, 17 S. E. 10, 19 L. R. A. 485, 26 Am. Law Rev. 193, 25 Am. Law Rev. 352.

² *Merrick v. Van Santvoord*, 34 N. Y. 208.

labor and capital. They claim such corporate franchises and immunities as may enable them to compete on equal terms with the citizens of other states. For these, from the structure of our institutions, they naturally look to their own government. They acknowledge a double allegiance in their local and federal relations, which, by general consent, carries with it a correlative community of rights. They may live in an inland state, but they are none the less citizens of a maritime nation, and they may lawfully organize companies at home for traffic on ocean highways.

“A corporate charter is in the nature of a commission from the state to its citizens, and their successors in interest, whether at home or abroad. Each government, in the exercise of its own discretion, determines the conditions of its grant. It is free to impose or omit territorial restrictions. It cannot enlarge its own jurisdiction but it can confer general powers to be exercised within its bounds or beyond them, wherever the comity of nations is respected. For the purposes of commerce such a commission is regarded, like a government flag, as a symbol of allegiance and authority; and it is entitled to recognition abroad until it forfeits recognition at home. * * *

“We think the policy of this state is in harmony with that of the country, and that it would be neither provident nor just to inaugurate a rule which would unsettle the security of corporate property and rights, and exclude others from the enjoyment here of privileges which have always been accorded to us abroad. Our national commerce is but the aggregate of that of the states, and every needless restriction, by the operation of local laws, is unjust and calamitous to all. We suppose the rules of comity on which we have heretofore acted to be generally accepted and approved. We see no reason why a Southern state may not grant to a

corporation of its planters the right to erect mills for the manufacture of their cotton in New England, nor why the legislature of Massachusetts may not authorize a company of Lowell millers to raise cotton in South America, or on the Sea Islands. The state of Illinois touches neither the Atlantic nor the Pacific; but if it should organize a company of its citizens to transport produce on the ocean with its offices in the City of New York and its business conducted by managers elected annually in Chicago, the rights of the corporation would be recognized wherever the obligations of national law are respected." See note.³ It is to be noted, however, that no rule of comity will allow one state to spawn corporations and send them forth into other states to be nurtured and do business there, when said first mentioned state will not allow them to do business within its own boundaries.⁴ This then reduces the question of the selection of the state of incorporation to two questions, namely; the advantages and disadvantages of foreign as distinguished from domestic corporations and business economy and expediency. Nearly all of the states and territories now have statutes permitting foreign corporations to do business within their boundaries and prescribing the terms and conditions for the doing of such business. It may be said, generally, that foreign corporations are no longer looked upon with fear or disfavor, but are permitted to carry on business in foreign states on fully as equal terms as domestic corporations, and in one or two states even, in some respects, upon more favorable terms. In the well considered case of *Demarest v. Grant*,⁵ the New York Court of Appeals, says, "The courts of any country recognize foreign corporations through what is termed 'national,

³ *Missouri Lead, etc. v. Rinehart*, 114 Mo. 218, 21 S. W. 488, 35 Am. St. Rep. 746.

⁴ *Landgrant, etc. Co. v. Coffey Co.*, 6 Kan. 245.

⁵ *Demarest v. Grant*, 128 N. Y. 205, 28 N. E. 645, 13 L. R. A. 854.

or state comity.' But whether such recognition shall be given must be decided by the courts of the country where the corporation seeks to do business. In our state, as in others, it is a question of domestic policy, and what that policy is must be determined by an examination of our own legislation. If we find any direct enactment upon the subject, it is our duty to obey it, and in its absence we must determine the question with reference to our general legislation and to the circumstances which surround us as a great and growing commercial community, having need of and employing large amounts of combined capital, and for whose prosperity and growth it is of the utmost importance that such capital should have the greatest facilities extended it for useful employment, with reasonable and proper personal exemptions from liability. We can find no reason for a domestic policy that should exclude from recognition, by our courts, foreign corporations generally. It may be safely said there can be no such domestic policy at the present day in a civilized state.

• • •

"An examination of our laws shows that it is, and for many years has been, the policy of this state to enlarge the facilities for the formation of corporations. General laws are on our statute book for the formation of corporations of almost every conceivable kind, and under some one of them a corporation of the kind mentioned in the case could readily be formed. The freedom from personal liability would be as great and could be as easily attained under our own as under the laws of West Virginia. The security of the creditor would not be substantially greater in the case of the domestic than in that of the foreign corporation. In the latter the creditor has the remedy by attachment, and he can obtain about as easy access to its property as if it were domestic instead of foreign.

“There is really nothing to evade by incorporating under a foreign law. No harmful results flow to a creditor, or to the community here, by such incorporation. Where the corporation formed under another jurisdiction comes here to do business of a kind which we permit to be done by corporations, and where our laws provide for incorporating individuals for the purpose of doing that business, it is difficult to see how the terms ‘evasion’ and ‘fraud’ can be properly applied to acts of our citizens whereby they obtain incorporation in another state. When they come in our state to do business they must conform to our laws relating to foreign corporations and comply with the terms laid down by us as conditions of allowing them to transact business here. In the case of many kinds of corporations such conditions have already been imposed by our laws, and if there be any kind where none is imposed it is conclusive evidence that up to this time the legislature has not thought it conducive to the true interests of the state and its citizens to impose them. I do not intimate that it is necessary for a state to expressly, by statute, exclude foreign corporations from acting within its jurisdiction. The policy of the state may exclude them, and that policy may be clearly established by a reference to the general legislation of a state. I find none such in the laws of this state.

“It has been urged that the easy way which our laws provide for forming corporations is itself a reason why we should not recognize as a corporation those of our own citizens who have gone to another state for the purpose of incorporating themselves under the laws thereof, to do business in our own state as such corporation.

“We think there is very little force in the argument. The public policy which we see in our own state, as evidenced by her laws upon the subject of the forma-

tion of corporations, is one which looks to their ready and easy formation as a means of transacting business with an accumulation of capital and an exemption from personal liability to the largest extent consistent with reasonable supervision by the state. The facilities for incorporation offered by this state are not the result of any desire to promote the formation of corporations here as against their formation in other states. They are offered because of a policy on our part which urges upon the state the propriety of furnishing them as one means of controlling the business done by them and keeping it within our borders. If in any particular case it is thought by those interested in the matter that the business can be done in our own state and by our own citizens with greater facility under the form of a foreign corporation than under that of a domestic one, there is no public policy which forbids its transaction under such form. The supervision of a foreign corporation by this state may easily be exercised by imposing terms as a condition of permitting it to do business here. The absence of any such terms in our legislation forms no reason for refusing to recognize the corporation. The power rests with the legislature to say whether any, and if so what, terms shall be imposed upon such corporations as a condition of granting them permission to do business here. Those terms can only be imposed by the legislature, and in their absence our courts ought not, merely on that account, to refuse to recognize a foreign corporation. In the absence of legislation, our courts must either refuse absolutely, or else they must recognize the right of such corporations to come to this state and do business here. The courts cannot themselves impose terms or conditions. * * *

“The truth is, foreign corporations are not properly to be regarded with suspicion, nor should unnecessary

restraints be imposed upon their doing business in our midst. They carry no black flag, and the policy of all civilized nations is to grant them recognition in their courts. It seems to me that every reason which urges upon us the recognition of foreign corporations organized with power to do business in our state, and composed of citizens of the foreign state is equally potent when the foreign corporation is composed of our own citizens. It has always been supposed that a state should at least deal as liberally with its own citizens as with those of foreign states. If, therefore, we permit foreign citizens to come within our limits in the form of a foreign corporation organized with power to do business here and recognized by us, why should we not permit our own citizens to avail themselves of the like privilege? If we impose terms and conditions upon foreign corporations, as such, doing business here, those same terms and conditions still and equally apply to a foreign corporation when composed of our own citizens. Why should they not be placed at least upon an equality with the foreign citizen?"

We have quoted at great length from these cases, for the reason that they not only correctly illustrate the question under consideration, but are very instructive as well. From a legal standpoint, then, it is seen that it is generally as safe to operate with a foreign corporation as a domestic corporation, so that the only consideration left and the most important one of all is the practical business issue to be determined almost wholly from a business standpoint.

§ 46. **Making stock full paid.**—Inquiry should always be made to determine if the laws of the state permit the capital stock to be paid with property, and if so, if they also permit the directors of the corporation to fix an arbitrary value upon the property to be purchased for the purpose of paying the capital stock, that

is making the capital stock full paid. It will be remembered in this regard that the laws of the state of incorporation must be complied with in paying the capital stock, and once the capital stock is full paid, there is no further liability, except statutory liability as hereinafter noted. A number of states now have statutes expressly providing that mines and mining properties may be purchased by the corporation, and stock issued as full paid in payment therefor.⁶ Some of these states go still farther and not only authorize the purchase of mines and mining properties and issue stock to the amount of the value thereof in payment therefor, but give to the directors the right to place an arbitrary value on such properties. The statute of Montana provides, "The directors of any corporation may purchase mines, manufacturing and other property necessary for its business, and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be declared and taken to be full paid stock and not liable for any further call; neither shall the holders thereof be liable for any further payments under the provisions of Section 470 of this code; provided that on mines, an arbitrary value may be fixed and such value shall, regardless of the actual value, be deemed the value thereof so as to make the stock issued in payment therefor at such arbitrary value full paid stock as above defined; and whenever stock has been heretofore issued by a corporation in payment for mines, purchased by it, such stock so issued shall be deemed full paid stock regardless of the actual value of the mine at the time of such purchase." In that state the case of *Kelly v. Clark*, 21 Mont. 291, 69 Am. St. Rep. 668, construing the constitutional provision thereof, holds that mining corporations, "Must not issue as

⁶ Colorado, Montana, Nevada, Washington, New Jersey, North Carolina and Maine.

paid in more stock in exchange for property taken than will fairly represent what the property is worth," exacting the same valuation in mining corporations as it does in any other class of corporations. This decision is based upon the constitutional provision of that state. The statute above referred to was passed after the case of *Kelly v. Clark* had been decided and was enacted to overcome the liability fixed by that case.

The Nevada statute provides that any corporation existing under any law of that state may issue stock for labor done or personal property, or real estate, or taxes thereof; in the absence of fraud in a transaction, the judgment of the directors as to the value of such property, real estate, or leases shall be conclusive. It is to be noted that the Nevada statute is practically the same as the statute of New Jersey, which statute has been construed in that court.⁷ In Wyoming the statute is substantially the same as Montana. In New Mexico "In the absence of fraud in the transaction, the judgment of the directors as to the value of property purchased shall be conclusive." Washington also has a similar special statute.⁸ These statutes, it will be seen, were passed in the interest of, and to promote the mining industry, by permitting corporations to pay up their entire capital stock with mining claims, regardless of the actual value of such claims.

It is advisable to organize mining corporations under laws having statutes similar to those just noted, for, if such statutes be valid and constitutional, they practically wipe out liabilities of stockholders for unpaid subscriptions. That is they make it possible for the incorporators to so organize the corporation as to eliminate this liability, which should be done under all

⁷ *Donald v. Am. Smelt. & Ref. Co.*, 61 N. J. E. 458, 48 Atl. 786; *See v. Heppenheimer*, 69 N. J. E. 36, 61 Atl. 843.

⁸ *Rem. & Ball. § 7347*; *In re Lancaster Mining Co.*, 30 Penn. St. 151; *Davies v. Ball*, 64 Wash. 292, 116 Pac. 833.

circumstances where it is possible. We are not passing judgment upon these statutes at this time. We simply mean to say that as long as they exist that it is right and proper that incorporators of mining corporations should take advantage of them.⁹

§ 47. **Liabilities.**—In addition to the liability for unpaid subscriptions, statutes of several of the states provide for separate liabilities known as statutory liabilities. In California, each stockholder of a corporation is individually liable for such portion of its debts and liabilities, as the amount of stock or shares owned by him bears to the whole of the subscribed capital stock or shares of the corporation. That liability has been extended to a foreign corporation doing business in the state of California, which rule is upheld by the Supreme Court of the United States.¹⁰

The general rule however is that the liability of the stockholders of a corporation for corporate debts depends upon the laws of the State in which the company was incorporated.¹¹

A number of other states,¹² have statutes imposing certain liabilities upon stockholders. Many of them,

⁹ For a full discussion of the constitutional provisions effecting these special statutes as well as the general statutes of the several states relating to paying of the capital stock, see "Full paid stock" of this work.

¹⁰ *Pinney v. Nelson*, 183 U. S. 144, 46 L. Ed. 125; *Thomas v. Wentworth Co. (Cal.)* 110 Pac. 942; *Peck v. Noee*, 154 Cal. 351, 97 Pac. 865.

¹¹ *Lewisohn v. Stoddard*, 78 Conn. 575, 63 Atl. 621; *McClure v. Paducah Iron Co.*, 90 Mo. App. 567; *Hobgood v. Ehlen*, 141 N. C. 344, 53 S. E. 857; *Hayward v. Sencenbaugh*, 141 Ill. App. 395; *Mountain Lake, etc. Co. v. Blair*, (Va.) 63 S. E. 751; *Platt v. Larter*, 94 Fed. 610; *Leyner Eng. Works v. Kempner*, 163 Fed. 605; *Johnson v. Tenn. Oil Co.*, (N. J. Ch.) 69 Atl. 788; *Converse v. Ayer*, 197 Mass. 443, 84 N. E. 98.

¹² Indiana, Massachusetts, Michigan, Minnesota, New York, North Dakota, Oklahoma, Pennsylvania, South Dakota, Tennessee and Wisconsin.

however, are more or less ineffective, and very little if any, attention is paid to them.

The statutes of the different states make the directors and officers liable both criminally and civilly for various acts of misfeasance and nonfeasance. The statute of Montana provides that, every director of any stock corporation who concurs in any vote or act of the directors of such corporation or any of them, by which it is intended, either, to make any dividend, except from the surplus profits arising from the business of the corporation, and in the cases and manner allowed by law; or, to divide, withdraw or in any manner, except as provided by law, pay to the stockholders, or any of them, any part of the capital stock of the corporation; or, to discount or receive any evidence of debt in payment of any installment actually called in and required to be paid, or with the intent to provide the means of making such payments; or, to receive or discount any note or other evidence of debt, with the intent to enable any stockholder to withdraw any part of the money paid in by him, or his stock; or, to receive from any other stock corporation, in exchange for the shares, notes, bonds or other evidences of debt of their own corporation, shares of the capital stock of such other corporation, or notes, bonds or other evidences of debt issued by such other corporation, is guilty of a misdemeanor.

In Nevada, if the directors make dividends except from the net profits, or reduce capital stock contrary to the statute they are jointly and severally liable to the corporation. Idaho has a statute substantially the same as the one above noted from Montana. In Oregon, if the directors of a corporation declare and pay dividends when the corporation is insolvent, or which renders it insolvent, or diminishes the amount of its capital stock, such directors shall be jointly and sev-

erally liable for the debts of the corporation then existing or incurred while they remain in office.

A number of states also have statutes requiring the officers and directors to file annual and other reports.¹³ These statutes usually provide that in the event the report so required is not filed, the officers and directors are made personally liable for the debts of the corporation.

Other questions that should be taken into consideration are: annual franchise tax; annual reports necessary to be filed; permitting stockholders' meetings to be held outside the state of incorporation; permitting amendments to the articles of incorporation; the liberality of statutes on permitting the appointment of receiver, the dissolution of the corporation and winding up of the corporate business; the term and duration for which the corporation may exist and the taxes.

Before leaving this question, it should be noted that corporations are not only bound by the laws of the state of their incorporation but acting as a foreign corporation, they are bound by the laws of the state wherein they seek to transact business. Under this rule it has been held that even though the corporation may have authority under the laws of the state of its incorporation, to do certain acts, yet if those acts are forbidden or unauthorized by the laws of the foreign state wherein the foreign corporation seeks to act, such acts cannot be carried out.

We have reserved for discussion the general common law liability of officers and directors elsewhere in this work.

¹³ *Cavanaugh v. Patterson*, 41 Colo. 158, 91 Pac. 1117; *Ford River Lbr. Co. v. Perron*, 148 Mich. 399, 111 N. W. 1074; *State Sav. Bank v. Johnson*, 18 Mont. 440, 45 Pac. 662, 56 Am. St. Rep. 591; *Mitchell v. Hotchkiss*, 48 Conn. 9, 40 Am. Rep. 146.

§ 48. **Cost of incorporation.**—The statutes of the several states vary greatly as to the initial cost of incorporating. Thus in Maine the incorporation or organization fee, when the capital stock exceeds five hundred thousand dollars, the cost is ten dollars for each one hundred thousand dollars of such capital stock, while in Pennsylvania the law requires that there shall be paid one-third of one percentum of the authorized capital stock. In New York the necessary cost is one-twentieth of one percentum upon the amount of the capital stock which the corporation is authorized to have and a like tax upon any subsequent issue. In New Jersey, if the capital stock authorized, does not exceed a hundred and twenty-five thousand dollars, the tax would be twenty-five dollars; where the capital stock exceeds a hundred and twenty-five thousand dollars, twenty cents for each one thousand dollars of the total amount of the capital stock authorized. In Montana, where the capital stock amounts up to one hundred thousand dollars, fifty cents per thousand; additional from one hundred thousand to two hundred and fifty thousand, forty cents per thousand dollars; additional from two hundred and fifty thousand to five hundred thousand, thirty cents per thousand dollars; additional from five hundred thousand to one million, twenty cents per thousand dollars; additional over one million, ten cents per thousand dollars.

In Idaho, ten dollars when the authorized capital stock does not exceed twenty-five thousand dollars; twenty dollars when the authorized capital stock does not exceed fifty thousand dollars; forty dollars when it does not exceed one hundred thousand dollars; sixty dollars when it does not exceed five hundred thousand dollars; one hundred dollars when it does not exceed one million dollars; one hundred fifty dollars when it exceeds one million. In Colorado, twenty dollars where

the capital stock does not exceed fifty thousand dollars; where the authorized capital stock exceeds fifty thousand dollars, there shall be paid an additional sum of twenty cents on every thousand dollars in excess of such amount. In California, fifteen dollars where the capital stock amounts to twenty-five thousand dollars or less; twenty-five dollars where it is over twenty-five thousand dollars and not more than seventy-five thousand dollars; fifty dollars where it is over seventy-five thousand dollars and not more than two hundred thousand; seventy-five dollars where it is over two hundred thousand dollars and not more than five hundred thousand dollars; one hundred dollars where it is over five hundred thousand dollars and not over one million dollars; where the capital stock exceeds one million dollars the charge will be fifty dollars for each five hundred thousand dollars or fraction thereof. In Minnesota, fifty dollars for the first fifty thousand dollars or any fraction thereof and five dollars for each additional ten thousand dollars or fraction thereof. In Nevada, ten cents for each thousand dollars of the total amount of the capital stock authorized. In Arizona, the fee is but ten dollars, while in Washington it is twenty-five dollars regardless of the amount of the authorized capital stock. There are, of course, other fees connected with the organization of corporations such as annual license fee, occupation tax and various other fees and charges.¹⁴ It is often found advisable to organize a corporation under the laws of the state wherein the capital to finance the scheme is to be raised.

¹⁴ See table in forms.

CHAPTER IX.

STOCK.

- § 49. Stock.
- 50. Capital stock.
- 51. Share of stock.
- 52. Certificate of stock.
- 53. Common stock.
- 54. Preferred stock.
- 55. Interest bearing stock.
- 56. Full paid stock.
- 57. Over-issued stock.
- 58. Watered stock.
- 59. Assessable stock.
- 60. Non-assessable stock.

§ 49. **Stock.**—The term stock has often been used to denote the capital stock of the corporation. It also has been used synonymously and interchangeably with shares of stock. Strictly speaking, there is a marked distinction between stock, capital stock, and shares of stock. However the word is difficult of intelligent definition. It has been defined as a fund. It also has been designated as “the sum of all the rights and duties of the shareholders.”¹

§ 50. **Capital stock.**—The capital stock of a corporation is the money or property contributed by the shareholders. It is the working fund of the corporation. A distinction is sometimes made between capital stock and paid up stock. Strictly speaking there is, of course, a distinction between capital stock and paid up capital. However, in general practice, there is little reason for this distinction, as the capital stock of a corporation is

¹ 26 Am. & Eng. Enc. of Law, 822; see also *Goodnow v. American Writing Paper Co.*, (N. J.) 69 Atl. 1015; *Wetherbee v. Baker*, 35 N. J. El. 501; *Cheeseborough v. City*, etc., 153 Cal. 559, 96 Pac. 288.

usually paid up at the organization meeting, so that before the corporation commences business, it has paid up capital.

Capital stock should not be confused with corporate assets. As a matter of fact, they bear little or no relation to each other. The assets of the corporation are its actual, tangible property, while the capital stock represents the amount of money or its equivalent, originally contributed by the shareholders. The latter may either increase, decrease, or, in time, be wholly lost. The capital stock usually must be fixed in the articles of incorporation, and cannot be increased or decreased, except according to law.

§ 51. **Share of stock.**—"A share of stock," says Sherwood, J., "is an incorporeal, intangible thing. It is a right to a certain proportion of the capital stock of the corporation never realized except upon the dissolution and winding up of the corporation—with the right to receive in the meantime such profits as may be made and declared in the shape of dividends."² "For the purpose of fixing the amount and subdivisions of the respective contributions of the corporators to the common fund, their proportionate interests in the corporate property, the voice which each shall have in its control and management, and the apportionment of the profits or losses of the enterprise, the whole of the capital stock is usually divided into equal portions called shares. Shares of stock are a species of incorporeal property consisting of rights in the profits, management, and assets of the company. They represent the extent of the interest which the various shareholders have in the capital and net earnings of the corporation."³

² *Neller v. Kelley*, 69 Pa. St. 407. See also, *Anderson's Dict. of Law* 975.

³ 26 Am. & Eng. Enc. of Law (2nd. Ed.) 825.

That is, a share of stock is a right to a certain undivided share of the capital stock, which right entitles the owner thereof to benefit in the management and disposition of the whole fund, and to partake according to the number held, of the surplus profits of the corporation, and upon the dissolution, or winding up of the corporation, the shareholder is entitled to his proportionate part of the corporate property and assets. Shares of stock are property in a certain sense, and are so recognized in law.

They are such property as may be the subject of conversion, and may be taxed. On the other hand, they are devoid of legal identity, that is, they are incapable of legal identification. Davis, J., of the supreme court of Maine,⁴ said, "A share in the capital stock of a corporation is merely some aliquot part of it, and not any particular part. Any designation, therefor, except by stating the owner or owners, would seem to be impossible. Even if the shares were consecutively numbered, of which there is no evidence, this would be the same. For, as a share is not any particular part, but merely an intangible, undivided proportion of the whole, the number would but designate the successive owner."

Contrary to the early view, shares of stock are now regarded as personal property, and may be taxed as such, notwithstanding the fact that the corporate property has already been assessed and taxed. Shares of stock being intangible and separate, and distinct from the corporate property, it necessarily follows that the ownership thereof does not entitle a person to a divided interest in the corporate property, nor does such ownership entitle him to take possession of any of the corporate property or assets.

§ 52. **Certificates of stock.**—The number of shares owned by the shareholder is usually evidenced in writ-

⁴ Skowhegan Bank v. Cutler, 52 Me. 509.

ing, called a certificate of stock. Certificates of stock are generally regarded as mere muniments of title or evidence of ownership of the shares. That is, that the certificates of stock is not the stock itself. However, notwithstanding this fact, the certificate itself is unquestionably property. We go even one step farther and suggest that the idea that certificates of stock are mere muniments of title, corresponding in a measure to a deed or bill of sale, and that they are simply receipts or evidences of ownership of the stock, is believed to be gradually giving way under the laws of trade, to a better and more sensible rule, to-wit: that a certificate of stock constitutes, for all business and practical purposes, the stock itself, and like a note or bill of exchange carries title in itself.

This is brought about by the fact that certificates of stock have come to be a common subject of barter and trade; they are handled, paid for, transferred, and delivered in the trade markets of the world every day; they pass from purchaser to purchaser, through scores of hands by simple endorsement in blank, without seeing the corporate books. They are a common subject of mortgage, pledge, lien, attachment and sale on execution; they are the subject of theft, larceny, embezzlement, conversion and forgery; they have been held to be the subject of taxation.

Commenting upon this question, the supreme court of New York says,⁵ "Certificates of stock are treated by business men as property for all practical purposes. They are sold in the market and they are transferred as collateral security for loans, and they are used in various ways as property. They pass by delivery from hand to hand, and they are the subject of larceny." Mr. Cook in his able work on corporations⁶ commenting

⁵ *Simpson v. Jersey, etc. Co.*, 165 N. Y. 193, 58 N. E. 896, 55 L. R. A. 796.

⁶ *Cook on Corporations* (5th Ed.), § 488.

upon this decision, says, "And it must be admitted that this decision, although apparently a wide departure from the common law, is a correct decision in view of the fact that certificates of stock have gradually grown to be more than mere receipts or evidence of stock, and have come to be the stock itself practically in business transactions, especially in America, and like a promissory note, a certificate of stock is property in itself, and carries title irrespective of the corporate books, and of transfer on the corporate books."

To the same effect is *Merritt v. American, etc. Co.*⁷ That court says, "But in the business world such obligations, or securities are treated as something more than mere muniments of title. They are daily bought and sold like other chattels. They may be either hypothecated or pledged. They have an inherent market value, and while differing in some respects from ordinary chattels, they are classified as personal property."

Hoyt, Judge of the supreme court of Washington in *Natl. Bank v. Gas & Fuel Co.*⁸ says, "It is a matter of common knowledge that shares of stock in corporations of all kinds are treated as personal property, transferable by endorsement and delivery, and from the very necessities of the business of a corporation, in the manner in which all corporations are now conducted, that rule which will most encourage the transfer of their stock and give to certificates as much as possible the character of commercial paper will best subserve the public interests." Stock certificates issued by a corporation having power to issue them, are a continuing affirmation of the ownership of the special amount of stock by the person designated therein, or his assignee, and a purchaser has a right to rely thereon, and

⁷ *Merritt v. American, etc. Co.*, 79 Fed. 228.

⁸ *Natl. Bank v. Gas & Fuel Co.*, 6 Wash. 597, 34 Pac. 155.

to derive the benefit of an estoppel in his favor against the corporation.

More than that the contents of a certificate of stock are a continuing affirmation by the corporation that everything contained therein is true. Thus, where the certificate contains upon its face a statement that it is full paid, it is a representation to the effect that the corporation has collected from the holder of such shares, the par value of such stock; and where the certificate contains the statement that the stock is non-assessable the corporation cannot afterwards, and without the consent of the holder of the stock, hold the shareholder liable for unpaid subscriptions, or make his stock assessable. It will thus be seen that corporations should exercise some care and discretion in issuing certificates of stock, and see to it that they do not contain statements that are false, or untrue, otherwise the corporation might by such false or fraudulent statements be involved in litigation.

§ 53. **Common stock.**—The usual class of stock that is issued by corporations is called common stock. All stock of the corporation, unless otherwise designated will be deemed, in law, to be common stock. Common stock is stock which entitles the owner, or holder thereof, to a pro rata part of the dividends, or earnings of the corporation, after the preferential rights granted to preferred stock are allowed, together with such other rights and privileges as are incident to corporate stock. There are no preferential rights incident to common stock.

§ 54. **Preferred stock.**—Preferred stock may be defined as “stock which entitles the holder to receive dividends from earnings of the company before the common stock is paid a dividend from such earnings.”*

* Cook on Corporations (5th Ed.), § 287.

In other words, preferred stock differs from common stock in the fact that it has certain preferential rights in the distribution of dividends. Thus, four percent preferred would mean that the holder thereof would be entitled to a four percent dividend, on such stock, before any dividend could be paid to the holder of common stock. It does not mean that the holder thereof is entitled to demand dividends from the corporation, regardless of its net earnings, for under all circumstances and in all cases, the corporation will not be required to pay, in dividends, more than its net profits amount to, so that, unless the corporate business earns the amount of the dividends, the holder of such preferred stock would not be entitled to it, but would be entitled to such earnings of the corporation as would be considered net earnings. Indeed, where the certificate of such stock contained a guarantee of "Five percent, semi-annual dividend guaranteed," it was held that under the guarantee the preferred stockholders were entitled to five percent semi-annual dividends, where there were profits to pay them, and not otherwise.

Preferred stock is divided into cumulative and non-cumulative. Where the by-laws and certificate of stock is silent, as to whether or not the preferred stock is cumulative, it will be regarded as cumulative, in law. It is generally held that, where a certain dividend is guaranteed on preferred stock the guarantee has the effect of making such dividends cumulative.¹⁰ Calling stock preferred stock does not *per se* define the right in such stock, but these depend upon the statutes, or contract under which it was issued.¹¹ Therefore each certificate of preferred stock, which is the contract be-

¹⁰ Lockart v. Van Alstyne, 31 Mich. 76, 18 Am. Rep. 156; Taft v. Hartford, etc. Co., 8 R. I. 310, 5 Am. Rep. 575.

¹¹ Heller v. National Marine Bank, 89 Md. 602, 43 Atl. 800, 73 Am. St. Rep. 212, 45 L. R. A. 438.

tween the corporation and the stockholder, should define the rights of such stock. In addition to this, of course, the charter or by-laws should clearly define the status and rights of the preferred stock.¹² Preferred stockholders are under the same liabilities as common stockholders¹³ and in the absence of expressed limitations and restrictions, they possess all the rights of common stockholders. However very often will be found limitations and restrictions of various kinds.¹⁴

It is a common practice in the organization of a cor-

¹² The Certificate of Incorporation of the U. S. Steel Corporation, contains the following:

"The holders of the preferred stock shall be entitled to receive, when and as declared, from the surplus or net profits of the corporation, yearly dividends at the rate of seven per centum per annum and no more, payable quarterly on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividends on the common stock shall be paid or set apart; so that, if in any year dividends amounting to seven per cent. shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid or set apart for the common stock.

"Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly installments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the board of directors may declare dividends on the common stock, payable then or thereafter, out of any remaining surplus or net profits.

"In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the corporation, the holders of the preferred stock shall be entitled to be paid in full both the par amount of their shares and the unpaid dividends accrued thereon before any amount shall be paid to the holders of the common stock; and, after the payment to the holders of the preferred stock of its par value and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their respective shares." *Belfast, etc. Co. v. Belfast*, 77 Me. 445, 1 Atl. 362; see also "Rights of preferred stockholders" of this work.

¹³ *Miller v. Ratterman*, 47 Ohio State, 141, 24 N. E. 496.

¹⁴ See "Rights of Preferred Stockholders" of this work.

poration where watered or fictitious stock is to be used for the purpose of keeping down the dividends, to issue preferred stock to the amount of actual value of the property, and turn the payment therefor over to the owners of such property. Ordinarily preferred stock has the same right to vote as the common stock.

§ 55. **Interest bearing stock.**—Another, but very unusual class of stock closely related to preferred stock is stock promising to pay to the owner and holder thereof, a certain rate of interest. This is called interest bearing stock. Such stock may be issued by the corporation, unless there is some statutory, charter or by-law prohibition. The law now universally refuses to permit corporations to declare dividends, except from the net earnings of the corporate business. Many states now have statutes to this effect. Interest bearing stock falls within this rule, and a corporation cannot pay such interest except from the net earnings of the corporate business. Holders of such stock are of course stockholders in the corporation and entitled to the same rights and privileges as other stockholders.

This class of stock is sometimes used by mining corporations. The rate of interest is low and runs for a period, and sometimes is limited to a period of three, four, or five years. Our experience is that where this class of stock is issued and used by mining corporations, that it is simply a promotion scheme devised and used as a special inducement to investors. The argument is used that the investor receives interest from his investment during the promotion and development period of the mining property, and that before the time fixed in the certificate has fully expired, the mining property will be developed to a paying basis. Sometimes the interest as provided is paid from manipulations various in their results, but more often it is not paid at all.

It is usually safe to say that where interest is paid on this class of stock, it is not paid from the net earnings of the corporate business, but either from the money received from the sale of the stock, or from manipulations that amount to practically the same thing. All in all, this is a very dangerous class of stock to issue, and should seldom, if ever, be used. It has been used so often by "wild catting" concerns, that investors now have a tendency to class a corporation undertaking to promote its property with interest bearing stock, as a "wild cat" corporation, and, we must confess that this one of the very strong ear-marks of that class of corporations. Space does not permit us to go into the various schemes, plans and devices that are conceived and put into operation by promoters for the purpose of selling the stock of the corporation.

A plan that is often used in connection with interest bearing stock is to have the interest promised to be paid upon such stock, guaranteed by some trust company, for a certain period of time. This is reprehensible from the fact that before such guarantee can be secured, some collateral, or pay must be delivered to such trust company, which is usually the corporate funds. That scheme amounts to simply taking the money paid into the treasury of the corporation for stock, and paying it out again, to boom the stock which belongs to the treasury of the corporation.

§ 56. **Full paid stock.**—We now come to the most important question relating to the stock of the corporation. Full paid stock is stock for which the corporation has received, or is supposed to have received full par value, either in money, property or labor. Statutes of nearly all of the states now provide substantially that the "stockholders of every corporation shall be severally and individually liable to the creditors of the corporation in which they are stockholders to the

amount of the unpaid stock held by them respectively, for all acts and contracts made by such corporation, until the whole amount of the capital stock subscribed for shall have been paid in.”¹⁵

After full par value of the stock has once been paid, there is no further liability under these statutes. Therefore, it would seem that to properly protect the purchasers of the stock of the corporation, where the same is sold by the corporation for less than par, some way must be devised of paying up the capital stock of such corporation. The usual method, as we have heretofore suggested is, at the organization meeting of the corporation, to transfer to it property, and to issue for such property the entire capital stock of the corporation. Thereafter there is donated back to the treasury of the corporation, a certain amount of the stock so issued, and thus paid up.

Many courts now hold, where the property has not been grossly or fraudulently over valued, that such a plan is legal and there is no liability attached to the stock under such conditions. However, it is to be noted that this manipulation cannot always be construed in law as a valid payment of capital stock. Immunity from liability for the debts of the corporation is one of the inducements which has led to the multiplication of private corporations. By the grant of a charter, immunity is granted to certain individuals called stockholders, on the condition, however, that the laws under which the grant is made, which is in effect a contract between the state and the stockholders, are complied with. That condition and contract, to take the place of personal liability, provided for the creation of a fund, or capital, for the payment of the creditors who have extended credit and relied upon the asserted value

¹⁵ Montana Civil Code, § 470.

of the corporate property, as represented by its paid up capital stock.

Now, unless this condition is complied with by the organizers and stockholders of the corporation, then it necessarily follows that the immunity from personal liability has not been granted, while on the other hand, if the legal conditions have been complied with, their immunity follows as a matter of law.¹⁶ It must be remembered that the granting of a charter does not, *ipso facto*, guarantee to the stockholders immunity from paying the debts of the corporation, but immunity from paying the debts of the corporation is secured by paying for the stock at the par value thereof, thereby creating the fund required by law as a substitute for the personal liability. Thus it will be seen that the purpose of the capital stock of a corporation is well defined.

The fact that the charter authorizes and permits the corporation to issue stock not to exceed a certain amount, does not of itself create anything of intrinsic value. It simply confers authority to issue stock in the amounts stated in accordance with the provisions of the law under which the corporation is created. The stock is issued to persons desiring to become stockholders, who for such stock are supposed to pay to such corporation, the par value in either money or its equivalent. That the stock must be paid for by the stockholders does not admit of doubt. However, the law is well settled that it need not be paid for in money, unless the governing statute expressly requires it to be paid for in that way. The law is now well settled that stock can be paid for in either money, property or labor.

Payment with money is of course a very simple trans-

¹⁶ Kelly v. Clark, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. 668.

action and has given rise to very little litigation, except where purchased for less than its par value. Paying for stock with property, or labor has given rise to much serious litigation, owing to the many and various schemes and devices used to pay up the capital stock with property at an over valuation, or labor at an exorbitant price.

In California originated the idea and custom afterwards sanctioned by law, of permitting the amount of the capital stock of mining corporations to be fixed and determined at a purely arbitrary sum, divided into as many shares as best suited the judgment and wishes of the organizers. It seems to have become established, by custom, in California, and to a certain extent sanctioned by law, upholding the idea that the capital stock of a mining corporation was never intended to bear the slightest relation to the real value of the mining property; and that a creditor would have no claim against the stockholders for unpaid stock, if their shares were declared paid up as between them and the corporation.¹⁷ It will thus be seen that the law laid down in these cases makes a marked distinction between mining and other corporations, in the manner of paying up the capital stock. We shall have occasion to comment upon these decisions and this custom elsewhere in this section.

Under the sanction of these cases, the custom referred to spread, and the practice eventually grew up, and was followed in nearly all of the Pacific states, where mining corporations were organized and promoted, of transferring to the corporations at the organization meeting, mining claims, in many cases wholly worthless, and issuing therefor the entire capital stock

¹⁷ In re South Mont. Consolidated Min. Co., 7 Sawyer, 30, 5 Fed. 405; In re South Mont. Consolidated Min. Co., 14 Fed. 347; see also Ross v. Silver & Copper Island Min. Co., 29 N. W. 591; 31 N. W. 219

of the corporation as full paid stock, and then donating presumably enough stock to the corporation to develop the mine. Advantage of course was immediately taken of this custom, and these laws, and they were used by the promoters and organizers of corporations to secure possession of the entire capital stock, without giving, or promising to give, anything of value therefor. After the issuance of the entire capital stock to the organizers, a certain percent thereof would be donated back to the corporation and placed in the treasury, which treasury stock would be at the disposal of the board of directors, who in turn would offer it to the investing public for the ostensible purpose of securing money to work and develop the mine, but usually and in most cases, for the real and only purpose of getting money to pay salaries, travelling expenses, promotion fees, and to create a market for their own individual stock, which they usually palmed off on the innocent and unsuspecting public, at a few cents a share; and when the bubble burst, the innocent and unfortunate investor, as well as the helpless creditor, was a loser, while the industrious and ingenious promoters would be found promoting another enterprise for the same purpose.

“That it was a pernicious custom is indisputable. It led to deceit, and to fictitious estimates being placed on mining property by the incorporators, for their own gain. Shares in a mine, at a few cents each, allured the unsuspecting and venturesome. The experiences of the custom are filled with disappointment and ruin to investors, rich and poor. All these matters may have been the controlling reason for the adoption of the more honest policy of our laws. Judge Buck, whose opinion, as a district judge was read to us on the argument of this case, adverted to the argument of custom in this way: ‘This custom has made the very word “mine” in financial centers of the world almost synonymous with

conspiracy to defraud. The caution of capital has become so trepid that I believe it is no exaggeration to state that many a half-worked rich mine lies idle to-day in the mountains of this state through this cause alone.' "

Indeed it can safely be said that this custom and practice is in a large measure responsible for the vicious system of "wild catting" which still prevails in many parts of the mining West. It is a system that is as vicious and wicked as it is dishonest, and that has dealt a blow to legitimate mining that will require stringent laws and years of time to heal. While this custom and practice still prevails to a certain extent, it is nevertheless no longer sanctioned by law, except possibly in one or two states. In the constitutions of several of the Western states the foundation has been laid for a proper remedy for the evils complained of.¹⁸ These constitutional provisions, as well as similar constitutional provisions in other states have been construed by the courts of several of the states, involving questions which are fully discussed elsewhere in this work.

Continuing the discussion of this question, the supreme court of Montana, says, "Whatever may have been the reason of the old system, things have changed. Estimating the value of a mine is no longer the result of hasty conjecture. Former methods have given way to scientific tests, based upon geological conditions, underground surveys and measurements, careful examinations of ore in sight, the known history of ore bodies in the vicinity, the method and cost of treatment of the ore, together with facilities for its transportation to markets," and concluding, "The conclusions we have

¹⁸ California, art. 12, § 11; Colorado, art. 15, § 9; Idaho, art. 11, § 9; Montana, art. 15, § 10; South Dakota, art. 7, § 8; Washington, art. 12, § 6.

reached in this case are in accord with those bolder interpretations which uphold, rather than impair, the letter of the constitution and the laws of the state. Enforcement of the liability in this the first action brought before this court involving the important questions considered and determined, may be a hardship; yet the policy upon which the statutes are founded is most wholesome. In the course of the history of the state, the maintenance of those principles which we have followed will intercept the further growth of a system by which 'wildcat' corporations have done grievous wrong to the public generally. The law has said to the incorporators of mines: 'You must not issue as paid in more stock in exchange for property taken than will fairly represent what the property is worth. It thus exacts no more from you than it does from the incorporators of manufacturing schemes. You must be fair and honest in valuing your mine properties, so that your capital stock may be assumed to represent what is actually paid in. It requires no impossibilities from you, but it insists on identically the same good faith from you as a miner that it calls for from your neighbor as a manufacturer.' This is sound law, good public policy and is founded upon principles of morality and equity, and it is to protect alike the innocent investor and the honest promoter; and if followed, will go a long way to correct many abuses prevalent in the mining West.

The effect of this decision is sought to be destroyed by the passage of a statute in the state of Montana providing that in paying up the capital stock of a mining corporation, on mines, an arbitrary value may be fixed and determined, and such value shall, regardless of the actual value, be deemed to be the actual value thereof.¹⁹ However, it must be said that it is difficult

¹⁹ See Laws of Montana, 1895.

to understand how this statute can affect the holding of *Kelly v. Clark*, quoted above, when that decision construed a constitutional provision, upon which the law of the decision is founded. The constitutionality of this and other similar statutes will be considered elsewhere.

A number of decisions now place mining corporations on the same footing and subject to the same rules and liabilities regarding the payment of the capital stock with property, as other corporations.²⁰ It would seem from the above authorities that mining corporations are no exception from the principles applicable to other corporations respecting the issue of stock in exchange for property, in paying up its capital stock.

As has already been suggested, the right to issue stock creates nothing of intrinsic value. The corporate franchise gives a right to issue stock only in accordance with the law creating the right, therefore, before stock can be legally issued, there must be some consideration passing to the corporation. One of the principal ends sought by incorporation is to limit the personal liabilities to the amount actually invested in the stock, and where par value is paid for the stock, or where the stock has been fully paid with property or labor in accordance with the governing statutes of the state, under which the corporation is organized, there is no personal liability. The law has said however, that there must be some provision for the protection of the creditors of the corporation, hence the establishment of the trust fund doctrine, which is in effect, hold-

²⁰ *Salt Lake Hdw. Co. v. Tintic Milling Co.*, 13 Utah, 423, 45 Pac. 200; *Thayer v. El Pomo Min. Co.*, 40 Ill. App. 344; *Gogebic Inv. Co. v. Iron Chief Min. Co.*, 78 Wis. 427, 47 N. W. 726, 23 Am. St. Rep. 417; *Oliphant v. Min. Co.*, 63 Iowa, 332, 19 N. W. 212; *Hodges v. Min. Co.*, 9 Ore. 200; *Douglas v. Ireland*, 73 N. Y. 100; *Cook on Corporations*. Note § 30. *Kelly v. Clark*, 21 Mont. 291, 53 Pac. 959, 69 Am. St. 668, 42 L. R. A. 621.

ing that the capital stock of a corporation is a trust fund for the benefit of the creditors.

This fund, the paid up capital, is placed under the management of the directors, who in law, thereby become and are, trustees for the creditors. This being true, it would seem that the stock when originally issued, should be paid for in money at the par value thereof, or in property or labor, of an equivalent value. It seems that the law is well settled in nearly all the states permitting the stock of a corporation to be paid by transferring property therefor. Such transactions however, "have been upheld only where the purchase of the property has been made in good faith, and the property taken in payment of the stock subscriptions has been paid in at a fair, *bona fide* valuation, and the courts have inflexibly enforced the rule that the payment of the stock subscription is good as against creditors, only where payment has been made in money, or what may be fairly considered as money's worth."²¹

The supreme court of the United States in *Camden v. Stuart*,²² says: "It is the settled doctrine of this court that the trust fund arising in favor of creditors by subscription to the stock of a corporation, cannot be defeated by a simulated payment of such subscription, nor by any device short of actual payment in good faith." Then it would necessarily follow, says the supreme court of Washington, "for the protection of creditors who dealt with these corporations, that the stock subscribed for must be paid in cash or in property of an equivalent value. In other words, the corporation must be in the actual condition which it represents itself to be in, financially. If it were allowed to hold itself out as having a capital stock of \$100,000 when, in reality, the capital stock, which is and must be, under

²¹ *Wetherbee v. Baker*, 35 N. J. E. 501.

²² *Camden v. Stuart*, 144 U. S. 104, 12 Sup. Ct. 585, 36 L. Ed. 363.

the theory of the law, assets in the hands of the corporation, is worth only one-half that amount, the corporation is to that extent doing business under false colors, and is obtaining credit upon the faith of an asserted estate which is purely fictitious. And where, by any arrangement between the shareholders and the corporation, the stock is issued as fully paid up, when in fact it has not been paid to the full amount of its face value, but has been paid in property of a fictitious or inflated value, a court of equity will compel a payment by the stockholder for the benefit of the creditor who has dealt with the corporation, relying upon the asserted value of its assets to the full amount or face value of the stock. Such is almost the universal holding of the courts of the present day."²³

²³ *Adamant Mfg. Co. v. Wallace*, 16 Wash. 614, 48 Pac. 415. See also:

United States: *Sanger v. Upton*, 91 U. S. 56, 23 L. Ed. 220; *Camden v. Stuart*, 144 U. S. 104, 12 Sup. Ct. 585, 36 L. Ed. 363; *Scovill v. Thayer*, 105 U. S. 143; *Wood v. Dummer*, 3 Mason, 308, 30 Fed. Cas. 435; *In re Remington, etc. Co.*, 139 Fed. 766.

Alabama: *Elyton Land Co. v. Birmingham, etc. Co.*, 92 Ala. 407, 12 L. R. A. 307, 25 Am. St. Rep. 65, 9 South. 129; *Glenn v. Semple*, 80 Ala. 159, 60 Am. Rep. 92; *Vaughn v. Ala. Natl. Bank*, 143 Ala. 572, 42 South. 64; *Montgomery Iron Wks. v. Roman*, 147 Ala. 434, 41 South. 811; *Hall v. Ala., etc. Co.*, 143 Ala. 464, 39 South. 285.

Arizona: *Johnson v. Tennessee Oil Co.*, 69 Atl. (N. J.) 790.

Arkansas: *Jones v. Ark. Agricultural, etc. Co.*, 38 Ark. 17; *Lester v. Bemis Lmbr. Co.*, 71 Ark. 379, 74 S. W. 518.

California: *Walter v. Merced Academy Ass'n*, 126 Cal. 582, 59 Pac. 136.

Connecticut: *Buck v. Ross*, 68 Conn. 29, 35 Atl. 763, 57 Am. St. Rep. 60; *Crandell v. Lincoln*, 52 Conn. 73, 52 Am. Rep. 560; *New Haven Trust Co. v. Gaffney*, 73 Conn. 480, 47 Atl. 760.

Georgia: *Allen v. Grant*, 122 Ga. 552, 50 S. E. 494.

Illinois: *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Sprague v. Natl. Bank*, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17; *Melvin v. Lamar Ins. Co.*, 80 Ill. 446, 22 Am. Rep. 199.

Indiana: *Bent v. Underdown*, 156 Ind. 516, 60 N. E. 307.

Iowa: *Wishard v. Hansen*, 99 Iowa, 307, 68 N. W. 691, 61 Am. St. Rep. 238; *Stout v. Hubbel*, 104 Iowa, 499, 73 N. W. 1060; *Osgood v.*

The law is believed to be well settled in America, that when stock is issued for property taken at an over valuation, the holders of such stock, with knowledge that the property has been over valued purposely, will be compelled to pay to the corporate creditors the difference between the real value of the property transferred and the par value of the stock issued. However, it is to be noted that when liability is sought to be enforced against the stockholders, much difficulty will be encountered to determine the *quantum* of proof necessary to fix the shareholder's liability. To properly understand the seemingly irreconcilable conflict that exists in the courts upon this question, a review of the history of paying up the capital stock of the corporation should be had.

King, 42 Iowa, 478; *Jackson v. Traer*, 64 Iowa, 469, 52 Am. Rep. 449, 20 N. W. 764.

Kansas: *Ryan v. Leavenworth Elec. Co.*, 21 Kan. 365; *Calef v. Wyandotte Co.*, 70 Kan. 318.

Kentucky: *Miller v. Higginbotham's Admr.* (Ky.) 93 S. W. 655.

Maine: *Libby v. Tobey*, 82 Me. 397; *Gillin v. Sawyer*, 93 Me. 151, 44 Atl. 677.

Maryland: *Crawford v. Rohrer*, 59 Md. 599.

Michigan: *Peninsular, etc. Bank v. Black Flag, etc. Co.*, 105 Mich. 535, 63 N. W. 514.

Minnesota: *Wallace v. Carpenter Elec. Co.*, 70 Minn. 321, 73 N. W. 189, 68 Am. St. Rep. 530; *Farnsworth v. Robbins*, 36 Minn. 369, 31 N. W. 249; *Hastings Matlg. Co. v. Iron Range Co.*, 65 Minn. 28, 67 N. W. 652.

Missouri: *Van Cleve v. Berkey*, 143 Mo. 109, 44 S. W. 743, 42 L. R. A. 593; *Anheuser-Busch Brew. Ass'n v. Prk. Novelty Co.*, 120 Mo. App. 513, 97 S. W. 209; *Garrett v. Kan. City Coal Min. Co.*, 113 Mo. 330, 20 S. W. 965, 35 Am. St. Rep. 713; *Meyer v. Ruby Trust Min., etc. Co.*, 192 Mo. 162, 90 S. W. 821.

Montana: *Kelly v. Clark*, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. Rep. 669.

Nevada: *Thompson v. Reno Sav. Bank*, 19 Nev. 103, 7 Pac. 68, 3 Am. St. Rep. 797.

New Jersey: *Wetherbee v. Baker*, 35 N. J. E. 501; *See v. Heppenhelmer*, 69 N. J. E. 36, 61 Atl. 843; *Easton Natl. Bank v. Am. Brick Co.*, 69 N. J. E. 326, 60 Atl. 54; *Bickley v. Schlag*, 46 N. J. E. 533, 20 Atl. 250; *Easton Natl. Bank v. Am. Brick Co.*, 70 N. J. E. 732, 64

Space for such a discussion cannot be allotted in a work of this character, therefore, we will consider the question under four heads or subdivisions, which it is believed will so segregate the authorities upon this question that an intelligent understanding can be had. We shall divide the subject: first, those courts announcing what is generally known as the "full value" rule; second, those courts announcing what is generally known as the "good faith" rule; third, those courts that predicate the right of recovery upon fraud and misrepresentation; fourth, the holdings under the constitutional and statutory provisions pertaining to this question.

The full value rule is, of course, the natural outgrowth of the principle of law announced by Mr. Justice Story in *Wood v. Dummer*, *supra*, and goes to the extent of requiring the stock to be paid for with money or money's worth, at the par value thereof. That is, the property received for the stock issued, must be equiva-

Atl. 917; *Voley v. Nixon*, 60 *Atl.* (N. J.) 139; *Johnson v. Tennessee Oil Co.*, 69 *Atl.* 790; *Honeyman v. Haughey* (N. J. E.) 66 *Atl.* 582.

New York: *Slee v. Bloom*, 19 *Johns.* 456, 10 *Am. Dec.* 273; *Douglass v. Ireland*, 73 *N. Y.* 100; *Boynnton v. Hatch*, 47 *N. Y.* 225; *Natl. Tube Wks. v. Gilfillan*, 124 *N. Y.* 302, 26 *N. E.* 538; *Flour City Natl. Bank v. Shire*, 88 *N. Y. App. Div.* 401, 84 *N. Y. S.* 810.

North Carolina: *Marshall, etc. Co. v. Killian*, 99 *N. C.* 501, 6 *S. E.* 680, 6 *Am. St. Rep.* 539; *Smathers v. Western, etc. Bank*, 135 *N. C.* 410, 47 *S. E.* 893.

Ohio: *Gilmore v. Cincinnati Bank*, 8 *Ohio*, 62; *Gates v. Tippecanoe Stone Co.*, 57 *Ohio St.* 60, 48 *N. E.* 285, 63 *Am. St. Rep.* 705; *Security Trust Co. v. Ford*, 75 *Ohio St.* 322, 79 *N. E.* 474, 8 *L. R. A.* (N. S.) 263.

Oregon: *Macbeth v. Banfield*, 45 *Ore.* 553, 78 *Pac.* 693, 106 *Am. St. Rep.* 670; *Hodges v. Min. Co.*, 9 *Ore.* 200.

Utah: *Salt Lake Hdw. Co. v. Tintic Milling Co.*, 13 *Utah*, 423, 45 *Pac.* 200.

Washington: *Adamant Mfg. Co. v. Wallace*, 16 *Wash.* 614, 48 *Pac.* 415; *Dunlap v. Rauch*, 24 *Wash.* 620, 64 *Pac.* 807; *Campbell v. McPhee*, 36 *Wash.* 593, 79 *Pac.* 206; *Davis v. Ball et al.*, 116 *Pac.* 833.

Wisconsin: *Gogebic Inv. Co. v. Iron Chief Min. Co.*, 78 *Wis.* 427, 23 *Am. St. Rep.* 417, 47 *N. W.* 726.

lent, in value, to the par value of the stock, and that it is not necessary to allege or prove fraud.

The supreme court of the United States, in the cases of *Fogg v. Blair*, and *Handley v. Stutz*,²⁴ would seem to place that court in the "good faith" rule. However, the later case of *Camden v. Stuart*,²⁵ says, "It is the settled doctrine of this court that the trust rising in favor of creditors by subscription to the stock of the corporation, cannot be defeated by a simulated payment of such subscription, nor by any device short of an actual payment in good faith. And while any settlement, or satisfaction, of such subscription may be good as between the corporation and the stockholders, it is unavailing as against the claim of the creditors. Nothing that was said in the recent cases of *Clark v. Bever*, *Fogg v. Blair*, or *Handley v. Stutz*,²⁶ was intended to over-rule, or qualify, in any way the wholesome principle adopted by this court in the earlier cases, especially as applied to the original subscribers to stock." It is to be observed in passing, that the early cases of this court, from *Wood v. Dummer*, held that a creditor had the right to presume that the stock subscribed had been or would be paid up, and if it were not, a court of equity would, at the instance of the creditor, require it to be so paid.²⁷

In New York, the case of *Gamble v. Queen County Water Co.*²⁸ seems to modify the former rule in that

²⁴ *Fogg v. Blair*, 139 U. S. 118, 35 L. Ed. 104; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227.

²⁵ *Camden v. Stuart*, 144 U. S. 104, 12 Sup. Ct. 585, 36 L. Ed. 363.

²⁶ *Clark v. Bever*, 139 U. S. 96, 35 L. Ed. 88; *Fogg v. Blair*, 139 U. S. 188, 35 L. Ed. 104; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227.

²⁷ *Scovill v. Thayer*, 105 U. S. 143, 26 Law. Ed. 968; *Sawyer v. Hoag*, 17 Wall 610, 21 Law. Ed. 731; *Sanger v. Upton*, 91 U. S. 56, 23 Law. Ed. 220.

²⁸ *Gamble v. Queen County Water Co.*, 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527.

state, by holding that the law permitting the purchase of property and issuance of stock to the amount of the par value thereof in payment therefor, meant that the stock should be the representative, dollar for dollar, of the money that had been paid in for its purchase. And again, in the later case of *National Tube Wks. v. Gilfillan*,²⁹ it is held that by proof that the stock of the company has been issued as full paid stock which has not been full paid, a legal fraud is established; it is not necessary to show otherwise an actual fraudulent intent. So also, if it is shown that the stock was issued in payment for property with the knowledge on the part of the trustees that the value of the property was much less than the amount of the stock, no other fraudulent intent than that which is evidenced by the action of the trustees need be shown to authorize recovery.

The supreme court of Illinois in *Colman v. Howe*, *supra*, after a review of many of the leading cases upon this subject, says "Some of the cases hold that the over valuation will not render the stockholder liable for the difference between the actual and accepted values, unless there is affirmative proof of fraud, aliunde. But other cases hold what we regard as the better view, namely, that where property whose value is well known or can be easily learned, is taken at an exaggerated estimate, the strong presumption is raised that the valuation is not in good faith, and is made for a fraudulent purpose." This presumption is conclusive unless rebutted by contrary evidence explanatory of the apparent fraud.

The supreme court of Missouri, in the very able and well considered case of *Van Cleve v. Berkey*, *supra*, says, "Hence, the inquiry, in a case between the creditor and a stockholder, when property has been paid in for the capital stock of a corporation, is not whether the stockholder believed, or had reason to believe, that

²⁹ *National Tube Works v. Gilfillan*, 124 N. Y. 302, 26 N. E. 538.

the property was equal in value to the par value of the capital stock, but whether in point of fact it was such equivalent." This wholesome and salutary doctrine, is beneficial to the public and to all corporations doing business with a *bona fide* capital.³⁰

It must be conceded that some courts have sought to give a wider latitude to the judgment and discretion of the board of directors, in purchasing property for the corporation, and issuing stock therefor, than was originally recognized under the trust fund doctrine as announced by Mr. Justice Story in *Wood v. Dummer*. Hence, the establishment of a rule known as the "good faith" rule, which is to the effect that unless over valuation of the property transferred to the corporation as payment for the shares issued was fraudulent and intentional, or that it was grossly and obviously over valued as to be constructively fraudulent, there can be no recovery from the shareholder.

That is, before recovery can be had, there must be proof of fraud in the transaction. In other words, where stock has been issued for property at an over valuation, in the absence of an affirmative showing of fraud in the transaction, the over valuation will not render the stockholder liable for the difference between

³⁰ *Libby v. Tobey*, 82 Me. 397, 19 Atl. 904; *Natl. Tub Wks. v. Gillan*, 124 N. Y. 302, 26 N. E. 538; *Gates v. Tippecanoe Stone Co.*, 57 Ohio St. 60, 48 N. E. 285, 63 Am. St. Rep. 705; *Wallace v. Carpenter Elec. Co.*, 70 Minn. 321, 73 N. W. 189, 68 Am. St. Rep. 530; *Adamant Mfg. Co. v. Wallace*, 16 Wash. 614, 48 Pac. 415; *Henderson v. Turngreen*, 9 Utah, 432, 35 Pac. 495; *Salt Lake Hdw. Co. v. Tintic Milling Co.*, 13 Utah, 423, 45 Pac. 200; *Elyton Land Co. v. Birmingham Warehouse, etc. Co.*, 92 Ala. 407, 9 South. 129, 25 Am. St. Rep. 65, 12 L. R. A. 307; *Chisholm Bros. v. Forny*, 65 Iowa, 333, 21 N. W. 664; *Steut v. Hubbell*, 104 Iowa, 499, 73 N. W. 1060; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Sprague v. Natl. Bk. of America*, 172 Ill. 149, 50 N. E. 19, 64 Am. St. Rep. 17, 42 L. R. A. 607; *Shickle v. Watts*, 94 Mo. 410, 7 S. W. 274; *Camden v. Stuart*, 144 U. S. 104, 36 L. Ed. 363; *Altenberg v. Grant*, 85 Fed. 345, 29 C. C. A. 185.

the actual value of the property transferred and the par value of the stock issued; the mere fact that the property was over valued not being sufficient unless it is so grossly over valued as to be fraudulent as a matter of law.³¹

Of later years several courts have brought into existence an entirely new principle upon which liability incident to stock issued for property over valued, is predicated. It must be conceded that the trust fund doctrine of Justice Story, announced in *Wood v. Dummer*, *supra*, is gradually becoming obsolete and has practically been abolished in a number of jurisdictions. It must be admitted also, that courts following the laws of trade, are gradually, but with sure and certain effect, lessening the liability of shareholders of corporations upon stock issued for property at an over valuation, until several of the states now predicate the right of recovery, by creditors against stockholders, where stock has been issued in payment for property at an over valuation, upon the ground of fraud and misrepresentation. Typical of this class of cases, is the case of *Hospes v. Northwestern Mfg. Co.*³² "It is difficult," says Mitchell, J., in the opinion of this case, "if not impossible, to explain or reconcile these cases upon the 'trust fund' doctrine or, in the light of them, to predicate the liability of the stockholder upon that doctrine. But by

³¹ *Colt v. Gold Amalgamating Co.*, 119 U. S. 343, 30 Law. Ed. 420; *Fogg v. Blair*, 139 U. S. 118, 35 Law. Ed. 104; *Clark v. Bever*, 139 U. S. 96, 35 Law. Ed. 88; *Handley v. Stutz*, 139 U. S. 417, 35 Law. Ed. 227; *Bickley v. Schlag*, 46 N. J. E. 533, 20 Atl. 250; *Van Cott v. Van Brunt*, 82 N. Y. 535; *Gilkie & A. Co. v. Dawson, etc. Co.*, 46 Neb. 334, 64 N. W. 978; *Young v. Erie Iron Co.*, 65 Mich. 111, 31 N. W. 814; *Kelly Bros. v. Fletcher*, 94 Tenn. 1, 28 S. W. 1099; *Rickerson Roller Mill Co. v. Farrell*, 75 Fed. 554; *N. W. Mutual Ins. Co. v. Cotton Exch.*, 70 Fed. 155; *Turner v. Bailey*, 12 Wash. 634, 42 Pac. 115; *Kroenert v. Johnson*, 19 Wash. 96, 52 Pac. 605.

³² *Hospes v. Northwestern Mfg. Co.*, 48 Minn. 174, 197, 31 Am. St. Rep. 637, 50 N. W. 1117, 1121, 15 L. R. A. 470; *Macbeth v. Banfield*, 45 Ore. 553, 78 Pac. 693, 106 Am. St. Rep. 670.

putting it upon the ground of fraud, and applying the old and familiar rules of law, on that subject, to the peculiar nature of a corporation, and the relation which its stockholders bear to it and to the public, we have at once rational and logical ground on which to stand. The capital of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on the faith of it. They have a right to assume that it has paid-in capital to the amount which it represents itself as having; and if they give it credit on the faith of that representation, and if the representation is false, it is a fraud upon them; and in case the corporation becomes insolvent, the law, upon the plainest principles of common justice, says to the delinquent stockholder, 'Make that representation good by paying for your stock.' It certainly cannot require the invention of any new doctrine in order to enforce so familiar a rule of equity. It is the misrepresentation of fact in stating the amount of capital to be greater than it really is that is the true basis of the liability of the stockholder in such cases; and it follows that it is only those creditors who have relied, or who can fairly be presumed to have relied, upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holders of 'bonus' stock. This furnishes a rational and uniform rule, to which familiar principles are easily applied, and which frees the subject from many of the difficulties and apparent inconsistencies in which the 'trust fund' doctrine has involved it; and we think that even when the trust fund doctrine has been invoked, the decision in almost every well-considered case is readily referable to such a rule."

While it may be said that the above principle could possibly have been the result of a number of decisions in both the United States and state courts, it must be

confessed that it never was the intention of such courts to wipe out the trust-fund doctrine. True, the rule has long been settled that an equity does not arise absolutely in every case to stockholders where property has been over valued, or where the stock has been sold below par. It is also true in a number of jurisdictions that where credit has been extended to the corporation prior to the transaction complained of, the creditor cannot recover.³³ So too, it is law in a number of jurisdictions that corporate creditors who contract or extend credit to the corporation, with full knowledge that the stock has not been fully paid, or paid with property at an over valuation, or sold for cash below par, cannot complain or enforce liability.³⁴

The logical result of these cases, is the conclusion reached by the Minnesota case hereinbefore cited. That is, that stockholders' liability must be and is predicated upon fraud and misrepresentation. However, it is to be noted that none of these cases intentionally wipe out the trust fund doctrine. Of course all of these cases are very liberal when it comes to establishing what actually constitutes fraud, in the issuance of stock which has never been paid up.

"Hence, in a suit by such creditor against the holders of 'bonus' stock, he could not truthfully allege, and could not affirmatively prove, that he believed that the

³³ *Colt v. Gold Almagamating Co.*, 119 U. S. 343, 30 Law. Ed. 420; *Handley v. Stutz*, 139 U. S. 417, 35 Law. Ed. 227; *First Natl. Bank v. Gustin, etc. Mining Co.*, 42 Minn. 327, 18 Am. St. Rep. 510, 44 N. W. 198, 6 L. R. A. 676.

³⁴ *Bank of Ft. Madison v. Alden*, 129 U. S. 372, 32 Law. Ed. 725; *State, etc. Co. v. Turner*, 111 Iowa, 664, 82 N. W. 1029, 53 L. R. A. 136; *Berry v. Rood*, 168 Mo. 316, 67 S. W. 644; *Woolfolk v. January*, 131 Mo. 620, 33 S. W. 432; *Col. Trust Co. v. McMillan*, 188 Mo. 547, 87 S. W. 933, 107 Am. St. Rep. 335; *Meyer v. Ruby Trust Min. & Milling Co.*, 192 Mo. App. 162, 90 S. W. 821; *Miller v. Higgenbotham's Admrs. (Ky.)* 93 S. W. 655; *Lea v. Iron Belt Mer. Co.*, 147 Ala. 421, 42 South. 415, 119 Am. St. Rep. 93, 8 L. R. A. (N. S.) 279; *Davies v. Ball (Wash.)* 116 Pac. 833.

defendants' stock had been paid for, and that he gave the corporation credit on the faith of it, although, as a matter of fact, he actually gave the credit on the faith of the financial standing of the corporation, which was based upon its apparent and professed amount of capital. The misrepresentation as to the amount of capital would operate as a fraud on such a creditor as fully and effectually as if he had personal knowledge of the existence of the defendants' stock, and believed it to have been paid for when he gave the credit. For this reason, among others, we think that all that it is necessary to allege or prove, in that regard, is that the plaintiff is a subsequent creditor; and that if the fact was that he dealt with the corporation with knowledge of the arrangement by which the 'bonus' stock was issued, this is a matter of defense."³⁵

"The fraud," says the supreme court of New York in *National Tube Wks. v. Gilfillan*,³⁶ "Is consummated by the issue of stock as full paid, stock which has not been fully paid, and it does not depend upon any fraudulent intent other than that which is evidenced by the act of knowingly issuing stock for property, to an amount in excess of its value." Again, it has been held that where stock has been issued for property at an over valuation, and the property is so grossly and obviously over valued as to preclude errors of honest conviction and judgment, then the transaction will be held to be fraudulent as a matter of law.³⁷

³⁵ *Hospes v. Northwestern Mfg. Co.*, 31 Am. St Rep. 648, 48 Minn. 174, 50 N. W. 1117; 15 L. R. A. 470.

³⁶ *Natl. Tube Wks. v. Gilfillan*, 124 N. Y. 302, 26 N. E. 538.

³⁷ *Lloyd v. Preston*, 146 U. S. 630, 36 Law. Ed. 1111; *Bank v. Alden*, 129 U. S. 372, 32 Law. Ed. 725; *Dickerman v. Northern Trust Co.*, 80 Fed. 452; *Phelan v. Hazard*, 5 Dill. 45, 19 Fed. Cas. 429; *Taylor v. Cuming*, 127 Fed. 108; *Northern Trust Co. v. Company*, 75 Fed. 936; *State v. Webb*, 110 Ala. 214, 20 South. 462; *Elyton Land Co. v. Birmingham, etc. Elevator Co.*, 92 Ala. 407, 25 Am. St. Rep. 65, 9 South. 129, 12 L. R. A. 307; *Smith v. Ferries, etc. R.*

The question of actual value, of the property, where the same is in dispute, is a question of fact.³⁸ It is a common practice to stamp upon the face of the certificate of stock, "full paid, non-assessable." The holder thereof with knowledge, if the stock be fictitiously paid up, is liable to the extent of the actual deficiency. That is, liable to the creditors for the difference between the actual value of the property transferred to the corporation to pay such capital stock up, and the par value thereof.³⁹ And this is true, notwithstanding the fact that there was no fraudulent intent in the issuance of

R. Co., 51 Pac. 710; *Coleman v. Howe*, 154 Ill. 458, 45 Am. St. Rep. 133, 39 N. E. 725; *Sprague v. Natl. Bank*, 172 Ill. 149, 50 N. E. 19, 64 Am. St. Rep. 17, 42 L. R. A. 606; *Goodrich v. Reynolds*, 31 Ill. 490, 83 Am. Dec. 240; *Parmelee v. Price*, 208 Ill. 544; *Bruner v. Brown*, 139 Ind. 600, 38 N. E. 318; *Wishard v. Hanson*, 99 Iowa, 307, 68 N. W. 691, 61 Am. St. Rep. 238; *Jackson v. Traer*, 64 Iowa, 469, 20 N. W. 764, 52 Am. Rep. 449; *N. H. H. N. Co. v. Company*, 142 Mass. 394, 7 N. E. 773; *Young v. Iron Wks.*, 65 Minn. 111, 31 N. W. 814; *Wallace v. Carpenter Elec. Co.*, 70 Minn. 321, 73 N. W. 189, 68 Am. St. Rep. 530; *Hastings Maltg. Co. v. Company*, 65 Minn. 28, 67 N. W. 65; *Kelly v. Clark*, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. Rep. 668; *Gilkie, etc. Co. v. D. T., etc. Co.*, 46 Neb. 333, 64 N. W. 978; *Wetherbee v. Baker*, 35 N. J. E. 501; See *v. Heppenheimer* (N. J. E.) 61 Atl. 843; *Natl. Tube Wks. v. Gillfillan*, 124 N. Y. 302, 26 N. E. 538; *Douglass v. Ireland*, 73 N. Y. 100; *Gamble v. Queen's County, etc. Co.*, 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527; *Marshall v. Killian*, 99 N. C. 501, 65 South. 680, 6 Am. St. Rep. 539; *Gates v. Tippecanoe Co.*, 57 Ohio St. 60, 48 N. E. 285, 63 Am. St. Rep. 705; *MacBeth v. Banfield*, 45 Ore. 553, 78 Pac. 693, 106 Am. St. Rep. 670; *Van Cleve v. Berkey*, 143 Mo. 109, 44 S. W. 743, 42 L. R. A. 593; *Salt Lake Hdw. Co. v. Tintic, etc. Co.*, 13 Utah, 423, 45 Pac. 200; *Adamant Mfg. Co. v. Wallace*, 16 Wash. 614, 48 Pac. 415; *Gogebic Inv. Co. v. Iron Chief Min. Co.*, 78 Wis. 427, 47 N. W. 726, 23 Am. St. Rep. 417; *Manhattan Trust Co. v. Seattle Coal, etc. Co.*, 16 Wash. 499, 48 Pac. 333.

³⁸ *Manhattan Trust Co. v. Seattle Coal, etc. Co.*, 19 Wash. 493, 53 Pac. 951.

³⁹ *Honeyman v. Haughey* (N. J. E.), 66 Atl. 582; *Vaughn v. Ala. Natl. Bank*, 143 Ala. 572, 42 South. 64; *Vogler v. Punch*, 205 Mo. 558, 103 S. W. 1001; *In re Remington Automobile Co.*, 153 Fed. 345; *Davies v. Ball* (Wash.), 116 Pac. 833.

the stock, on the part of the directors of the corporation.⁴⁰

The illegality of the transaction has been held to be no defense in an action of this kind.⁴¹ The law is believed to be well settled that any device resorted to by the corporation, which has for its purpose, the release of subscribers to stock from the amount that is justly due the corporation, is fraudulent as to the creditors, and is no defense in an action for unpaid subscription.⁴² *Bona fide* purchasers are not liable on fictitiously issued stock. That is, stock that has been issued for a fictitious consideration, provided such *bona fide* purchasers are innocent of the method used in paying up such stock.⁴³ Where the liability is fixed by statute, or by constitutional provisions, such liability cannot be changed by provisions of the articles of incorporation.⁴⁴

A number of states now have statutory and constitutional provisions prohibiting the issuance of fictitious, or watered stock. These statutes and constitutional provisions were passed in the several states wherein they exist, in response to a general demand from an "up rising" public, and to prevent the unscrupulous from converting the stock of corporations at the organization thereof, to their own use and benefit, by pretending to pay therefor with worthless property, or by other means and devices that are so commonly and generally used. These provisions in the states wherein they exist, are quite uniform, and will be found to contain substantially, "No corporation shall issue stock or bonds, except for labor done, services performed or money and

⁴⁰ *Anheuser-Busch Brew. Ass'n v. Park Novelty Co.*, 120 Mo. App. 513, 97 S. W. 209.

⁴¹ *Vaughn v. Ala. Natl. Bank*, 143 Ala. 572, 42 South. 64.

⁴² *Hall v. Ala. T. & Imp. Co.*, 143 Ala. 464, 39 South. 285.

⁴³ *In re Remington Auto. & Motor Co.*, 153 Fed. 345; *Davies v. Ball* (Wash.), 116 Pac. 833.

⁴⁴ *Security Trust Co. v. Ford*, 75 Ohio St. 322, 79 N. E. 474, 8 L. R. A. (N. S.) 263.

property received.”⁴⁵ “Corporations shall not issue stock except to *bona fide* subscribers therefor, or their assigns. . . . All fictitious increase of stock, or indebtedness shall be void.”⁴⁶

These constitutional provisions have been confused with the old trust fund doctrine by several of the courts. It is difficult to understand why the courts should have construed them into any relation to the trust fund doctrine. That doctrine had alone to do with stock issued as full paid, but for which in fact, par value had not been paid in either money, property or labor, and making the holders of such stock liable to the creditors for the difference between the purchase price and the par value, but held such a contract valid and binding between the corporation and the shareholder. While constitutional provisions above referred to, if the language of the provisions means anything at all, render the stock issued in violation thereof, absolutely void.

It must be admitted that the courts have found some difficulty in construing these provisions, in several of the states wherein they exist, owing to the attempt to confuse them with the trust fund doctrine, and their reluctance to declare void the stock and bonds which had passed into the hands of *bona fide* purchasers for value. These provisions have a peculiarly important relation to mining corporations, as will be seen hereinafter.

While it is somewhat difficult to deduct a harmonious rule from the authorities, it is believed that all agree upon three propositions: First, where the issue of stock is entirely fictitious, that is, where no consideration passes to the corporation, the stock is void and the holder of the certificate does not thereby become a stockholder for any purpose. Second, where the pur-

⁴⁵ Mont. art. 15, § 10.

⁴⁶ Washington, art. 12, § 6.

ported consideration for the stock is property transferred to the corporation by the organizers thereof, at an intentional, fraudulent, gross and obvious over valuation, as, where the property is practically worthless, the issue of stock is a violation of the provisions referred to. Third, where the transaction is not *bona fide*, but a plain attempt to evade the law, then it falls under the ban of these provisions.

Mr. Cook, in his work on Corporations,⁴⁷ who it must be conceded, takes a most liberal view in favor of upholding the validity of the transfer of property for stock, inclines to the opinion that these constitutional provisions have wholly failed in their purpose. With all due respect to the able work of the learned author, it must be conceded that his liberal views are hardly sustained by the courts. Walker, J., speaking for the supreme court of Alabama, commenting upon these sections, says, "Our examination satisfies us that the weight of American authority does not support the statement made by Mr. Cook in Section 47 of this work on stocks and stockholders, to the effect that the attempts which have been made in cases where stock was issued for property taken at an over valuation, to hold the party receiving such stock liable for its full par value less the actual value of the property received from him, have been unsuccessful, and that if there has been an over valuation which is shown to have been fraudulent, then the contract is to be treated like other fraudulent contracts, and is to be adopted in toto, or rescinded in toto, and set aside. We have found no authority at all asserting the exemption of the stockholder from such liabilities, where it appeared that the stock subscriptions was governed by statutory regulation at all similar."⁴⁸

⁴⁷ Cook on Corporations (5th Ed.) § 47.

⁴⁸ See above citation.

The supreme court of the state of Missouri also takes issue with the learned author in a number of very well considered cases. In *Van Cleve v. Berkey*, that court says, "It is impossible to escape the conviction that in this state, whatever may be the case of some other states, 'the American trust fund' doctrine as suggested by Mr. Justice Harland, has indeed been re-enforced by its constitution and statutes, and that the proposition that the stock of a corporation must be paid for 'in meal or in malt,' in money or in money's value, is not a mere figure of speech, but really has the significance of its terms. It may be paid for in property, but in such case, the property must be the fair equivalent in value to the par value of the stock issued therefor; that it is the duty of the stockholders to see that it possesses such value; that when a corporation is sent forth into the commercial world accredited by them as possessed of a capital, in money, or its equivalent in property equal to the par value of its capital stock, every person dealing with it, unless otherwise advised, has a right to extend credit to it on the faith of the fact that its capital stock has been so paid for, and that the money or its equivalent in property will be forthcoming to respond to their legitimate demands; in short, that it is the duty of the stockholder and not of the creditor, to see that it is paid.'" ⁴⁹

The supreme court of the state of Montana in *Kelly v. Clark*,⁵⁰ by Hunt, J., says, "Higher authority than the statutes also exists to prohibit a corporation's issuing stock except for property actually received. The constitution of the state,⁵¹ provides as follows: 'No corporation shall issue stocks or bonds, except for labor done, services performed or money and property actu-

⁴⁹ *Van Cleve v. Berkey*, 143 Mo. 109, 44 S. W. 743, 42 L. R. A. 593.

⁵⁰ *Kelly v. Clark*, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. Rep. 668.

⁵¹ Montana, § 10, art. 15.

ally received; and all fictitious increase of stock or indebtedness shall be void. * * *’ In *Elyton Land Co. v. Birmingham etc. Co.*⁵² a clause in the constitution of Alabama, almost identical with section 10 quoted, was construed as effective against transfers of property deliberately and intentionally over valued to corporations for their stock. We approve of this construction.

The Constitution of Missouri,⁵³ contains a substantially similar clause; and in *Van Cleve v. Berkey*,⁵⁴ the supreme court decided it applied to a case like the one before us.” Thus it will be seen that Alabama, Missouri and Montana agree that these constitutional provisions have reinforced the old trust fund doctrine. Notwithstanding the very able views expressed by these courts, it is believed that such interpretation was never intended by the framers of these constitutional provisions, and if regard is had for the language of these provisions, it is difficult to understand how they can be construed into any relation to the old “trust fund doctrine.” It is believed that the better view is that expressed by those courts that hold that stock issued in defiance to these provisions is void.⁵⁵ These constitutional provisions will be further discussed under the title of “watered stock.”

The kind and character of property, the purposes for which it is accepted, the use to be made thereof and all the conditions surrounding the transaction must ever be kept in mind when considering this question. It should be remembered, also, that owing to the extremely

⁵² *Elyton Land Co. v. Birmingham, etc. Co.*, 92 Ala. 407, 9 South. 129, 12 L. R. A. 307, 25 Am. St. Rep. 65.

⁵³ Missouri, § 8, art. 12.

⁵⁴ *Van Cleve v. Berkey*, 143 Mo. 109, 44 S. W. 743, 42 L. R. A. 593.

⁵⁵ *First Ave. Land Co. v. Parker*, 111 Wis. 1, 86 N. W. 604, 87 Am. St. Rep. 841; *Kellerman v. Maler*, 116 Cal. 416, 48 Pac. 377; *Jefferson v. Hewitt*, 103 Cal. 624, 37 Pac. 638; *Clarke v. Lincoln Lumber Co.*, 59 Wis. 655, 18 N. W. 492; *Arkansas River Co. v. Farmers, etc. Co.*, 13 Colo. 587, 22 Pac. 954.

uncertain and fluctuating character of mining property, and the hazardous risks incident thereto, it is generally and well understood, by the general public, that the capital stock of a mining corporation does not and cannot furnish a safe estimate of the corporation's "paid in capital." Again the very nature of the undertaking is such that it is wholly impracticable, and next to impossible to develop the mining industry of the country save by corporations, whose capital stock is wholly paid up with mining properties. For these reasons it would seem that the widest possible range of latitude should be allowed in placing a valuation upon mining properties used to pay up the capital stock at the organization of the corporation. Indeed it is believed that the tendency of modern and recent decisions is to give a wide degree of latitude in fixing a valuation upon property, transferred to pay the capital stock in all speculative enterprises.⁵⁶

It is probably well to note in passing that contrary to the earlier California cases,⁵⁷ mining claims commonly called "prospects" are now regarded as having such a value that in law may be called a market value.⁵⁸ So that while a wide range of latitude should, and is allowed, in placing a valuation thereon, for the purpose of paying the capital stock of mining corporations, such valuations, however, should and must be kept within reasonable and proper bounds, and not carried to the

⁵⁶ *Iron, etc. v. Hays*, 165 Pa. St. 489, 30 Atl. 936; *Manhattan Trust Co. v. Seattle Coal Co.*, 19 Wash. 494, 53 Pac. 951; *R. R. v. Thompson*, 103 Ill. 187; *Kelly v. Clark*, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. Rep. 668; *Peck v. Coalfield Coal Co.*, 11 Ill. App. 88.

⁵⁷ *In re South Mountain Min. Co.*, 7 Sawyer, 30; 8 Sawyer, 366.

⁵⁸ *Kelly v. Clark*, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. Rep. 668; *Montana Ry. Co. v. Warren*, 6 Mont. 275, 12 Pac. 641; *Montana Ry. Co. v. Warren*, 137 U. S. 348; *Maloy v. Berkin*, 11 Mont. 138, 27 Pac. 442; *Northern Pac. Ry. Co. v. Forbis*, 15 Mont. 452, 48 Am. St. Rep. 692; *O'Keefe v. Dyer*, 20 Mont. 477, 52 Pac. 196.

extent of being fraudulent upon the face of the transaction. The general rule is now well settled that a corporation can issue stock as payment for any kind of property it might lawfully purchase or hold under its charter.⁵⁹ A number of states now have statutes expressly providing that mines and mining properties may be purchased and stock issued in payment therefor.⁶⁰ Some of the states go still further and not only authorize the purchase of mines and mining properties, and the issuance of stock to amount of value thereof, in payment therefor, but give the directors the right to place an arbitrary value thereon. Thus the statute of the state of Montana provides: "The directors of any corporation may purchase mines, manufactories and other property necessary for its business and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be declared and taken to be full paid stock and not liable for any further call, neither shall the holders thereof be liable for any further payments under the provisions of Section 470 of this Code; provided, that on mines any arbitrary values may be fixed and such value shall, regardless of the actual value, be deemed the value thereof, so as to make the stock issued in payment therefor at such arbitrary value, full paid stock as above defined." The constitutionality of the latter part of this section is very doubtful under the holding of *Kelly v. Clark*, for it is very evident that this section was passed to escape the

⁵⁹ *Lester v. Bemis, etc. Co. (Ark.)*, 74 S. W. 518; *Liebke v. Knapp*, 79 Mo. 22, 49 Am. Rep. 212; *Frenkel v. Hudson*, 82 Ala. 158, 2 South. 758, 60 Am. Rep. 736; *Kimbell v. Chicago, etc. Co.*, 119 Fed. 102; *Whitehill v. Jacobs*, 75 Wis. 474, 44 N. W. 630; *Washburn v. Natl. Paper Co.*, 81 Fed. 17, 26 C. C. A. 312; *Smith v. Martin*, 135 Cal. 247, 67 Pac. 779; *Calivada Col. Co. v. Hays*, 119 Fed. 202; *Garretson v. Pac. Crude Oil Co.*, 146 Cal. 184, 79 Pac. 839; *Am. Muntoscope Co. v. Board of Assessors*, 70 N. J. L. 172.

⁶⁰ Colorado, Montana, Nevada, Washington, New Jersey, North Carolina and Maine.

liability fixed upon mining corporations, by the holding of that case. It is to be noted that the case construes a constitutional provision of that state, upon which the decision is based, so that if it really does undertake to escape the consequences of the law laid down in that case it is unconstitutional. The Nevada statute provides that "Any corporation existing under any law of this state may issue stock for labor done, or personal property, or real estate or leases thereof; in the absence of fraud in the transaction, the judgment of the directors as to the value of such labor, property, real estate or leases shall be conclusive."⁶¹ It is to be noted that the Nevada statute is practically the same as the statute of New Jersey.⁶²

In Washington, the statute provides that "In incorporations already formed, or which may hereafter be formed under this chapter where the amount of the capital stock of such corporation consists of the aggregate valuation of the whole number of feet, shares, or interest in any claim in any mining claim in this state, for the working and development of which such corporation shall be or have been formed, no actual subscription to the capital stock of such corporation shall be necessary."⁶³ In Wyoming the statute is substantially the same as Montana. In New Mexico "In the absence of actual fraud in the transaction, the judgment of the directors as to the value of property purchased shall be conclusive." This statute is very similar to the New Jersey law. New York now has a similar statute, which clearly demonstrates that the tendency of the legislatures of the different states is to give to the di-

⁶¹ Nevada, Laws of 1903.

⁶² *Donald v. Am. Smelt. & Ref. Co.*, 61 N. J. E. 458, 48 Atl. 786; *Bank v. Company*, 60 Atl. (N. J.) 54; *See v. Heppenheimer*, 69 N. J. E. 36, 61 Atl. 843; *Honeyman v. Haughey*, 66 Atl. (N. J. E.) 582.

⁶³ *Rem. & Ball*, § 7347; *In re Lancaster Min., etc. Co.*, 30 Pa. St. 151; *Davies v. Ball*. (Wash.), 116 Pac. 833.

rectors valuing mines and mining property for the purpose of paying the capital stock in such corporations, a wide latitude in their judgment.

In addition to the liability for unpaid subscriptions as above noted, statutes in several of the states now exist imposing separate and additional liabilities. These are known as statutory liabilities. In California, each stockholder of a corporation is individually and personally liable for such portion of its debts and liabilities as the amount of stock or shares owned by him bears to the whole of the subscribed capital stock or shares of the corporation, and for a like proportion only of each debt or claim against the corporation.

It would seem under this statute that every shareholder is liable in proportion to the amount of stock owned by him at the time the debt or liability was incurred.⁶⁴ This liability has been extended to a foreign corporation doing business in the state of California, which rule was upheld in the U. S. Supreme Court.⁶⁵ Indiana, Massachusetts, Michigan, Minnesota, New York, North Dakota, Oklahoma, Pennsylvania, South Dakota, Tennessee, and Wisconsin all have statutes imposing certain liabilities upon the stockholders, some of them, however, being more or less ineffective.

§ 57. Over-issued stock.—Over-issued stock is stock issued in excess of the amount fixed and limited by the charter or articles of incorporation. It is to be remembered that the number of shares that a corporation is authorized to issue is fixed and limited by the articles of incorporation. The corporation has no power to issue a greater number than is therein authorized, ex-

⁶⁴ Laws of 1905, chap. 330; see also *Harmon v. Page*, 62 Cal. 448; *Baines v. Babcock*, 95 Cal. 581, 27 Pac. 674, 30 Pac. 776, 29 Am. St. Rep. 158; *Vermont Marble Co. v. Company*, 135 Cal. 579, 67 Pac. 1057; *Bank v. Company*, 103 Cal. 594, 37 Pac. 499.

⁶⁵ *Pinney v. Nelson*, 183 U. S. 144, 46 Law. Ed. 125; *Thomas v. Wentworth Hotel Co.*, 158 Cal. 275, 110 Pac. 942, 139 Am. St. Rep. 120.

cept of course, that the capital stock of the corporation is increased in the manner prescribed by law. There is no exception to the rule that we announce, that stock issued in excess of the amount fixed and limited by the articles of incorporation is absolutely and totally void, even in the hands of innocent purchasers for value.⁶⁶ It is wholly immaterial that the issue is made through error, mistake, or ignorance, for the act itself, whether fraudulent or done in good faith, is *ultra vires*. It is not a question of intent, but beyond the power of the corporation to do. While the law is well settled beyond exception that over-issued stock is absolutely void, yet the holder of a certificate, regularly signed and issued, by the officers of the corporation, and put into circulation, which certificate is afterward purchased and acquired in good faith for valuable consideration, is entitled to maintain an action against the corporation and recover his damages.⁶⁷

This is but an application of the old and familiar rule of law that the principal, "is liable to third persons in a civil suit for the frauds, deceits, concealments, misrepresentations, torts, negligence, and other misfeasances or malfeasances and omission of duty of his agent, in the course of his employment, although the principal did not authorize or justify, or participate in,

⁶⁶ *Scoville v. Thayer*, 105 U. S. 143, 26 Law. Ed. 968; *Bloomfield v. Charter Oak Bank*, 121 U. S. 135; *Winters v. Armstrong*, 37 Fed. 508; *Laredo Imp. Co. v. Stevenson*, 66 Fed. 633; *Ross-Mehan, etc. v. Southern Malleable I. Co.*, 72 Fed. 957; *Granger Life Ins. Co. v. Kamper*, 73 Ala. 325; *McCord v. Ohio Ry. Co.*, 13 Ind. 220; *Ryder v. Bushwick Ry. Co.*, 134 N. Y. 83, 81 N. E. 251; *Kampman v. Tarter*, 87 Tex. 491, 29 S. W. 768; *Railroad v. Sneed*, 41 S. W. 364.

⁶⁷ *Moore v. Citizens Natl. Bank*, 111 U. S. 156; *Boston & Albany Ry. v. Richardson*, 135 Mass. 473; *Pratt v. Taunton Copper Co.*, 123 Mass. 110, 25 Am. Rep. 37; *Supply Ditch Co. v. Elliott*, 10 Colo. 327, 15 Pac. 691, 3 Am. St. Rep. 587; *Tome v. Parkersburg Ry. Co.*, 39 Md. 36, 17 Am. Rep. 540; *Allen v. South Boston Ry. Co.*, 150 Mass. 200, 5 L. R. A. 716, 15 Am. St. Rep. 185, 22 N. E. 917; *People's Bank v. Kurtz*, 99 Pa. St. 344, 44 Am. Rep. 112.

or indeed did not know of such misconduct, or even if he forbade the acts, or disapproved of them."⁶⁸ And where the corporation has issued invalid stock, not constituting an over issue, they are likewise liable for the loss incurred, when it is purchased in good faith for valuable consideration, and the purchaser relied upon the validity of the stock.⁶⁹

It is to be noted here, that where a person deals with an officer of the corporation as an individual, as distinguished from his official capacity, the corporation will not be liable.⁷⁰ So too, it has been held that, "Where the by-laws of a corporation provide that all certificates of stock shall be signed by its president and treasurer, and such president, who is not the proper officer to issue certificates, makes a fraudulent issue thereof to himself, forging the name of such treasurer thereto, affixing the corporate seal, and pledging them for his individual debt, the corporation is not liable for his criminal fraud, as for an act made possible by its negligence, although he was allowed to have access to its seal and certificate book after his previous misconduct in violating an agreement to pledge certain stock to the corporation."⁷¹

We have heretofore called attention to the fact that certificates of stock duly and regularly issued by a cor-

⁶⁸ Story on Agency.

⁶⁹ Bridgeport Bank v. N. Y., etc. Ry. Co., 30 Conn. 231; Richardson v. Delaware Loan Ass'n, 32 Atl. 980; Western Md. Ry. Co. v. Franklin Bank, 60 Md. 36; Holbrook v. Jersey Co., 57 N. Y. 616; Cincinnati Ry. Co. v. Citizens Bank, 56 Ohio St. 351, 47 N. E. 249, 43 L. R. A. 777; Appeal of Kisterbock, 127 Pa. St. 601, 14 Am. St. Rep. 868.

⁷⁰ Lucile Dreyfus Min. Co. v. Willard, 46 Wash. 345, 89 Pac. 936; Moore v. City Bank, 111 U. S. 156; Farrington v. South Boston R. R. Co., 120 Mass. 406, 23 N. E. 109, 15 Am. St. Rep. 222, 5 L. R. A. 849.

⁷¹ Hill v. Jewett Pub. Co., 154 Mass. 172, 28 N. E. 142, 13 L. R. A. 193, 26 Am. St. Rep. 230; see also Moore v. Citizen's Natl. Bank, 111 U. S. 156.

poration having power to issue such stock is a continuing affirmation of the ownership of the special amount of stock by the person designated therein, or his assignee, and an innocent purchaser in good faith has a right to rely thereupon. However, it is to be noted that fraudulent stock certificates are not certificates in this sense. That is, they are not certificates in legal contemplation, and give no right to the holder thereof as a stockholder, nevertheless the act of the corporation in issuing such certificates and putting the same into circulation, where they are purchased, accepted and acted upon in good faith by an innocent purchaser, the corporation is estopped from denying their validity, provided always that such issue does not constitute an over issue. Of course, if such issue constitutes an over issue, then the stock is absolutely void, and the remedy of the holder thereof is an action for damages against the corporation.

A court of equity will, upon proper application of the corporation, or if the corporation refuses to act, upon the application of *bona fide* stockholders, cancel over issued stock upon the theory that it is a cloud upon the title of *bona fide* shareholders.⁷² Over issue of stock has no effect upon the validity of the original and valid issue of stock.⁷³ The question may sometimes be raised as to what actually constitutes an over issue of stock, under the charter and under the statutes of the state under which the corporation is organized. The law is clearly settled that before there is an over issue, there must be issued and outstanding at some one time, more than the legal amount of stock as named and lim-

⁷² New York, etc. R. R. Co. v. Schuyler, 17 N. Y. 592; Campbell v. Morgan, 4 Ill. App. 100; Stebbins v. Perry Co., 47 N. E. (N. Y.) 1048; Kemble v. New England Ry. Co., 68 N. H. 485, 45 Atl. 253; Lucile Dreyfus Min. Co. v. Willard, 46 Wash. 345, 89 Pac. 935; Hutton v. Bancroft, 83 Fed. 17.

⁷³ Byers v. Rollins, 13 Colo. 22, 21 Pac. 894.

ited in the articles of incorporation.⁷⁴ Thus, where old certificates have been surrendered to the corporation and new ones issued in their stead, it is no over issue, and where certificates have been issued in lieu of lost or destroyed certificates, it is no over issue. In fact, as we have suggested, there is no over issue unless the corporation issues as original stock, and places the same in circulation, more stock than is permitted by the articles of incorporation. Another question that may often arise is, to determine who is an actual *bona fide* purchaser for value.

It is needless, of course, to suggest that the law is settled absolutely that the corporation may recover from the director, or officer who is responsible for the fraudulent certificate being issued and put into circulation. The rule of agency, that a principal may recover from his agent any damage resulting from any unauthorized acts, applies with equal force to the directors and officers of the corporation. It is sometimes a little difficult to ascertain who is an innocent purchaser in good faith. Where the purchaser of spurious stock buys the stock with full knowledge of the facts, or has intimation that would put a reasonably prudent man on his inquiry, then it is doubtful if he can recover from the corporation.⁷⁵ On the other hand, where he is an innocent purchaser and has purchased in good faith, relying upon the validity of the stock certificate issued and put into circulation by the corporation, then he may sue the corporation for his damages.

The authorities cannot be harmonized upon the question as to what is sufficient to put a man upon his inquiry. They are settled, however, to the extent of holding that where a person goes to the office of the

⁷⁴ Wells v. Thompson Mfg. Co., 54 Mo. App. 41; Tulare Savings Bank v. Talbot, 131 Cal. 45, 63 Pac. 172; Kinnan v. 42nd St., etc. R. Co., 21 N. Y. Supp. 789.

⁷⁵ Byers v. Rollins, 13 Colo. 22, 21 Pac. 891.

corporation and is there given assurance that the stock is valid and legal, that this is sufficient inquiry, providing of course that he has dealt with the person as an officer of the corporation and not dealt with him in his individual capacity.

It is believed that all of these questions are determined after taking into consideration the facts and circumstances surrounding each particular case.

§ 58. **Watered stock.**—When stock is issued by a corporation and the certificate thereof represents that it is “full paid stock” it is a representation by the holder thereof, that he has paid to the corporation the full par value of such stock, and a representation by the corporation that it has received full par value for such stock either in money, property or labor. If the stock has not been so paid for, but has been paid with property at a fictitious, or inflated valuation, or purchased for cash at less than “par value” the stock is, to the extent of the difference between the amount paid, or the value of the property transferred, and the par value of the stock, watered stock, and the corporation is to that extent doing business under false colors. In other words, watered stock is stock whose certificate represents it to be “full paid up” stock, when in truth and in fact only a certain percent of the par value has been paid to the corporation.

The issuance of watered stock has brought much adverse criticism upon the corporate system, and has been the cause of a flood of litigation. Many and various schemes and plans have been devised from time to time, by promoters, to secure large blocks of stock in their corporations, without paying anything of value therefor. Of these but three methods will be noted, which are the prevailing methods now used in watered stock. First, by disposing of stock, other than treasury stock, for cash, at less than the par value thereof. Second, by

issuing stock for property purchased or labor paid for, at an over valuation, or fictitious price, and third, by issuing stock in the form of dividends. The second of these methods is now the most prevalent, and has given rise to much litigation. If the enterprise is a success very little, if anything, is ever heard of the watered stock, but when the enterprise fails and the assets of the corporation are inadequate to satisfy the creditors, then an attempt is usually made to collect from the stockholders, the difference between the value of the property and the par value of the stock issued. As already has been noted, much confusion and irreconcilable opinion exists in the courts of the different states of the union, where liability for unpaid subscriptions to the stock of corporations is sought to be enforced by creditors, upon the theory that where stock has been issued for property at an over valuation, the stock has never been paid for, except to the value of the property.

The rule seems to be well settled, in this country, that where stock is sold for cash, at a price less than the par value of the stock, the holder thereof is liable to the creditors of the corporation for the difference between the price paid and the par value of the stock.⁷⁶ But, where stock is issued for property at an over valuation, much difficulty is encountered to hold the shareholder liable. The common sense view of this whole question would seem to be that the issuing of stock as "full paid up," where it is not so in fact, should be branded as a public and private wrong, and any pretext or subterfuge, however ingenious it may be, used to disguise the real transaction, should be held a fraud upon the law, for it is notorious that in the end the innocent investor, and the deluded creditor are the ones who will suffer if such fraudulent methods are sanctioned by law.

⁷⁶ Cook on Corporations, §§ 32, 33, 34.

That courts have gone to both extremes, there is no denial.

That the laws of trade demand a reasonable latitude for speculation and manipulation, in the commercial world is heartily conceded and endorsed; that demand for organized capital, to keep pace with a great and growing country having endless undeveloped resources, has changed old rules and brought forth new and more liberal ideas, cannot be denied or criticized. However, notwithstanding the more liberal policy of the laws toward corporations, it must be confessed that the timidity of a few of the courts to check the fraudulent schemes that have gradually crept into the corporate organization system has had the effect of establishing some nice distinctions upon this and other questions. That it is the policy of the law to encourage the industries of the country has long been recognized and endorsed, but the spectacle of promoters having an option on certain property, that never cost them a cent, organizing a corporation with a capital of millions of dollars and so manipulating the whole organization as to have issued to themselves and associates, a majority of the whole stock, controlling and managing the corporation for their own personal gain and benefit, and acquiring all this interest and stock by transferring to the corporation their worthless option, being thus permitted to gull the innocent and unsuspecting public, by securing credit upon the representation that the corporation, through its issued certificates of stock, has property equal to the par value of the stock; and at the same time to rob the innocent investor by palming off this worthless stock at a few cents per share, will ever stand as examples and lessons to those laws whose sympathies for frail and penitent humanity have been able to reconcile such acts with principles of legitimate business enterprise, or established laws of trade. It is

no excuse to say that such fraudulent acts are so universal and notorious that a person who contracts with a corporation, in its promotion period does so at his peril, for that is but equivalent to saying that the corporation should be permitted to violate the law and deceive the public, at will.

Such arguments only bring reproach and contempt upon both the courts and the corporate system. A number of courts have held watered and fictitiously issued stock invalid.⁷⁷ Some few of the courts hold that a contract with the corporation to issue stock as fully paid up, when in fact the payment is intentionally fictitious, is *ultra vires*, and cannot be enforced.⁷⁸ Stockholders who do not acquiesce, or consent to the issuance of watered stock and dissent within a reasonable time under all the circumstances, may maintain an action to annul and have such stock cancelled.⁷⁹ On the other hand, the law is well settled that the corporation issuing the watered stock, as full paid, cannot subsequently repudiate the transaction and collect the unpaid subscription, in the absence of fraud. In other words, the contract is binding as between the corporation issuing

⁷⁷ *Gilman, etc. R. R. v. Kelly*, 77 Ill. 426; *Sturges v. Stetson*, 1 Biss. 246, 23 Fed. Cases 311; *Fosdick v. Sturges*, 1 Biss. 255, 9 Fed. Cases 501; *Fisk v. Chicago, etc. R. R. Co.*, 53 Barb. 513; *West Cornwall Ry. Co. v. Mowatt*, 12 Jur. Pt. 1, 407; *First Ave. Land Co. v. Parker*, 111 Wis. 1, 86 N. W. 604, 87 Am. St. Rep. 841; *Clarke v. Lincoln Lumber Co.*, 59 Wis. 655, 18 N. W. 492; *Spring Co. v. Knowlton*, 103 U. S. 49, 26 Law. Ed. 347; *Garrett v. Kansas City Coal Min. Co.*, 113 Mo. 330, 20 S. W. 965, 35 Am. St. Rep. 713.

⁷⁸ *Garrett v. Kan. City Coal Min. Co.*, 113 Mo. 330, 20 S. W. 965, 35 Am. St. Rep. 713; *Tobe v. Robinson*, 99 Ill. 222; *LeWarne v. Meyer*, 38 Fed. 191; *Lake, etc. Co. v. Ziegler*, 99 Fed. 114, 39 C. C. A. 431.

⁷⁹ *Campbell v. Morgan*, 4 Bradw. (Ill.) 100; *Gibson v. Thornton*, 112 Ga. 328, 37 S. E. 406; *Parsons v. Joseph*, 92 Ala. 403, 8 South. 788; *Homes v. New Castle, etc. L. R.* 1 Ch. D. 682; *Fisk v. Chicago, etc. R. R. Co.*, 53 Barb. 513; *Taylor v. Philadelphia, etc. R. R. Co.*, 7 Fed. 386; *Smith v. Ferries, etc. Co.*, 51 Pac. (Cal.) 710; *Coler v. Tacoma Ry. Co.*, 54 Atl. (N. J.) 413; *San Antonio, etc. Co. v. Adams*, 25 S. W. (Tex.) 639, 37 Tex. 125, 26 S. W. 1040.

the stock and the shareholder thereof.⁸⁰ The usual practice in incorporating and organizing corporations, is to dispense with subscription to the capital stock prior to the organization meeting, enabling the promoter to limit the membership to the actual incorporators until after the organization meeting is held. At this meeting all of the stockholders being present, who are as a matter of fact only the incorporators themselves, the proposition of issuing the entire capital stock of the corporation for property, thereby paying up the entire capital stock of the corporation, is accepted and the stock issued, the issue being thus authorized, by all the stockholders, and the corporation being estopped to question the transaction, both the stockholders and the corporation are bound and cannot subsequently repudiate the transaction in the absence of fraud.⁸¹ These cases conclude this question on two propositions; first, that when all of the stockholders consent and agree to the transaction, none but creditors can afterwards complain, and second, purchasers of stock subsequent to the transaction complained of, have no standing in court.

However, a few of the courts have been very apt to discover that the real motive for such an arrangement has been to evade certain provisions of the law and have laid down the better and more wholesome rule that, "If one or more persons acquire property, intending to promote the organization of a corporation to purchase it from them at a profit to themselves and effect such purpose, limiting the membership to interested parties, till the transaction is completed between

⁸⁰ *Dickerman v. North. Trust Co.*, 176 U. S. 181, 44 Law. Ed. 423; *Scoville v. Thayer*, 105 U. S. 143, 26 Law. Ed. 968; *Higgins v. Lanning*, 154 Ill. 301, 40 N. E. 362.

⁸¹ *Old Dominion Co. v. Lewishon*, 136 Fed. 915; *Foster v. Seymour*, 23 Fed. 65, 23 Blatch. 107; *McCracken v. Robison*, 57 Fed. 375, 6 C. C. A. 400; *Barr v. R. R. Co.*, 26 N. E. 145, 125 N. Y. 263.

them and the corporation, intending thereafter to cause the balance of the capital stock to be sold to outsiders, they being kept in ignorance of the true nature of such transaction, and effecting such intent, they are guilty of actionable fraud upon the corporation and responsible to it for the gains made. In such circumstances, in the making of the contract between the corporation and its agents, it is mere fiction as to its prospective members by original subscription.

"Since it has no one to stand for it as an adverse party in the transaction, no meeting of adverse minds, essential to a binding contract occurs. The corporation is deceived, in that advantage is taken of its incapacity to protect itself, as to the interests of prospective membership by the original taking of its stock."⁸²

As already has been noted, a number of states now have constitutional provisions prohibiting the issuance of watered, or fictitious stock, while other states have statutes similar to these constitutional provisions.⁸³

⁸² *Pietsch v. Milbrath*, 123 Wis. 647, 101 N. W. 388, 102 N. W. 342, 107 Am. St. Rep. 1017, 68 L. R. A. 951; *Hayward v. Leeson*, 176 Mass. 310, 57 N. E. 656, 49 L. R. A. 725; *Old Dominion Cooper Co. v. Bigelow*, 188 Mass. 315, 74 N. E. 653, 108 Am. St. Rep. 479; *Yelzer Paper Co. v. U. S., etc. Co.*, 107 Fed. 341, 52 L. R. A. 724; *Erlanger v. New Sombrero Phosphate Co.*, L. R. 3 App. Cas. 1236; *Gluckstein v. Barnes*, App. Cas. 240; *In re Olympia Ltd.*, 2 Cd. 153.

⁸³ Alabama has a constitutional provision to the effect that, "No corporation shall issue stock or bonds except for money, labor done, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void." The supreme court of Alabama has construed this constitutional provision on numerous occasions. The following cases will give an idea of the holding under various circumstances, under such a constitutional provision in that state: *Elyton Land Co. v. Birmingham, etc. Co.*, 92 Ala. 407, 9 South. 129, 25 Am. St. Rep. 65; *Beltman v. Steiner Bros.*, 98 Ala. 241, 13 South. 87; *Williams v. Evans*, 87 Ala. 725, 6 South. 702; *Perry v. Tuscalousa Cotton Seed Oil Mill Co.*, 93 Ala. 364, 9 South. 217; *Smith v. Alabama Fruit Growing, etc. Co.*, 123 Ala. 528, 26 South. 232; *Roman v. Dimmick*, 115 Ala. 233, 22 South. 109; *Parsons v. Joseph*, 92 Ala. 403, 8 South. 788; *Fitzpatrick v. Dispatch Pub. Co.*, 83 Ala. 604; *State v. Webb*, 110 Ala. 214, 20 South. 462.

It is very doubtful if these provisions were ever intended to strengthen the "trust fund doctrine" as con-

"Where parties organize a corporation with a capital stock of two hundred and fifty thousand dollars, and subscribe for the whole stock, giving in payment therefor, without actual fraud, a bond for title to land costing them five thousand dollars, the actual value of the land being fifty thousand dollars, for the payment of the remainder of the purchase price of which the corporation gives its notes, the stockholders are liable to the creditors of the corporation to the extent of the difference between the actual value of the property and the amount of their subscriptions, under constitutional provision prohibiting the issue of stock except for money or property actually received, and a statutory requirement that all stock subscriptions shall be paid in money or labor, or property at its money value." *Elyton Land Co. v. Birmingham Warehouse & Elev. Co., supra*. In *Williams v. Evans, supra*, where a corporation to be formed had agreed to issue \$5.00 worth of stock for \$1 of subscription, the stock not having been issued, when the contract which was the subject of the litigation was made, the court said, "A contract which contemplates the violation of a statute or a constitution, as a mode of executing such contract, is illegal and void. * * * One of the purposes of this clause of the constitution was to protect the public, as well as stockholders, against spurious and worthless stock by the process of watering, in other words, from fraudulently issuing and putting on the market fictitious corporate stock which is based on nothing valuable as a consideration for its issue. It is greatly to the interest of the public that the policy of this provision be enforced."

In California, § 359 of the Civil Code of that state provides that, "No corporation shall issue stock or bonds, except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void." A constitutional provision of the state of California, it is to be noted, exists to the same effect as this statute. See article 12, § 11, of the constitution of the state of California.

The supreme court of the state of California has had occasion to construe and comment upon this statutory provision in the following cases: *McKee v. Title Ins. & Trust Co.*, 113 Pac. 140; *Kellerman v. Maier*, 116 Cal. 416, 48 Pac. 377; *Jefferson v. Hewitt*, 103 Cal. 624, 37 Pac. 638; *Stain v. Howard*, 65 Cal. 616; *Pac. Trust Co. v. Dorcey*, 72 Cal. 55, 12 Pac. 49; *Smith v. Ferries, etc. R. Co.*, 51 Pac. 710; *Smith v. Martin*, 135 Cal. 247, 67 Pac. 779; *Stockton, etc. Co. v. Houser*, 109 Cal. 1, 41 Pac. 809; *Kellerman v. Maier* was an action by creditors to enforce the liability of subscriptions to corporate stock, for an unpaid balance. It appeared that the stock held by the defendants was bonus stock, that is, stock that had been issued by the

strued by Alabama, Missouri and Montana, but it is believed were passed to prevent the issuance of watered

corporation without consideration. The excuse for the issuance of the stock was, that it was issued for the purpose of equalizing the price of stock to certain stockholders who had purchased stock prior to that time. There was no new consideration of the issuance of the bonus stock. The court says: "Section 359 of the Civil Code, provides that no corporation shall issue stock or bonds except for money paid, labor done or property actually received. The certificate for 2,000 shares of stock referred to appear to have been issued in violation of this provision; and as they are so issued, they are void, and the parties receiving them did not thereby become stockholders or make themselves liable to the creditors, as having an unpaid subscription." Again in the case of *Jefferson v. Hewitt, supra*, this was an action brought by the assignee of a non-negotiable note, that had been given for stock in the corporation. The payment of the note was conditioned upon the completion of the railroad that was then being promoted by the corporation. In affirming a judgment for the defendants the court says:

"The point is made that where the defendants received the certificate of stock, they became liable to pay for it, and the conditions agreed upon as to payment as made was rendered void, leaving the obligation in full force. In support of this position, counsel cites § 359 of the Civil Code which provides that 'No corporation shall issue stock or bonds except for money paid, labor done or property actually received,' but if this section has any bearing on the case, it seems to us it must be construed to render void the certificate and not the condition of payment, and hence, the note was made without consideration." It is to be noted here that the sale of the stock need not be at the par value of the stock. In other words, it is not fictitious nor obnoxious to the constitutional and statutory provisions heretofore cited, to sell the corporate stock for less than its par value. *Stein v. Howard*, 65 Cal. 616, 4 Pac. 662.

In Colorado, § 9 of article 12 of the constitution provides that, "No corporation shall issue stock or bonds except for labor done, services performed, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void." This constitutional provision has been embodied in §§ 251 and 340 of the statute relating to corporations. The supreme court of Colorado has interpreted and construed these constitutional and statutory provisions on several occasions. *Arkansas River, etc. Co. v. Farmers' Loan, etc. Co.*, 13 Colo. 587, 22 Pac. 954, was an action brought by certain persons who claimed to be stockholders in the defendants' corporation and prayed for certain relief. The case turns on the question as to whether or not they are stockholders, so, that

stock, instead of holding the shareholder liable to creditors for unpaid subscriptions. The protection of the

question is the issue between the plaintiffs and the defendant corporation. The court said:

"Again, are the individual complainants in a situation to entitle them to invoke the aid of a court of equity? It is alleged in the bill that they are shareholders. It appears that they are nominally the holders of 4,000 shares of the capital stock of the company. It is expressly alleged in the bill that neither of these parties paid, nor agreed to pay, anything for the stock issued to them. There is some contention that they were the owners of four shares of stock, upon which something was paid, but the fact that the whole or the greater part of the money paid was received back on account of claims which arose before the corporation was organized, makes the contention unworthy of consideration. The naked question presented is whether these parties, as holders of 4,000 shares of fictitious capital stock, are shareholders of the company, and in a position to entitle them to be heard in a court of equity. The rights of third persons are not involved, in this case, and the sole question is whether as between the parties, fictitious stock, issued by a corporation, has any validity; in other words, whether the parties to whom such stock is issued become shareholders, in any legal or equitable sense.

"The purpose of the capital stock of a corporation is well understood. The fact that by a certificate of incorporation, the capital stock of a company is fixed at a specific sum does not of itself create anything of value. Its effect is simply to confer authority to issue capital stock to the amount stated, in accordance with the provisions of the law under which it was created and organized. This power constitutes a corporate franchise. It can only be exercised by means of contracts entered into with persons who desire to become stockholders. Such contracts when based upon a consideration and enforceable, constitute the sole test by which the question can be determined whether a person claiming to be a stockholder is such in fact. There must be mutuality. The stockholder must be in a position to enforce his rights, and compel the corporation to recognize him as a stockholder. The corporation must be able to enforce the subscription agreement. Any discussion of the terms and conditions upon which such contracts might be made at common law is unnecessary in this state, because, by the organic law itself, the powers of bodies corporate in this respect are expressly declared. Section 9 of article 15 of the constitution provides that 'No corporation shall issue stocks or bonds, except for labor done, services performed, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void.' This constitutional provision has been embodied in sections 251 and

general public, instead of the creditor was the purpose of their passage. This is the view entertained by writers and some of the courts.

340 of the statute relating to corporations. The meaning of the language of the constitution is clear and unmistakable. If stocks or bonds be issued, 'except for labor done, services performed, or money or property actually received,' such issue is in direct violation of the constitution and the statutes, and *ipso facto* invalid. The provision of the constitution of the state of Illinois relating to this subject is the same, in effect, as that of this state, except that its operation is confined to railroad corporations. In the case of Railroad Co. v. Thompson, 103 Ill. 187, this provision was construed. In that case it was held that 'the object of section 13, article 11 of the present constitution, in providing that "no railroad corporation shall issue any stock or bonds except for money, labor or property actually received and applied to the purposes for which such corporation was created;" and that "all stock, dividends, and other fictitious increase of the capital stock, or indebtedness of such corporation, shall be void," was to prevent reckless and unscrupulous speculators, under the guise or pretense of building a railroad or of accomplishing some other legitimate corporate purpose, from fraudulently issuing and putting upon the markets bonds or stocks that do not and are not intended to represent money or property of any kind, either in possession or in expectancy, the stock or bonds in such case being entirely fictitious.' A like statute of the state of Wisconsin was considered in the case of Clarke v. Lumber Co., 59 Wis. 655, 18 N. W. Rep. 492. In the course of the opinion Taylor, J., says, 'The contract for the sale and purchase of the stock was clearly void under the statute. The statute was a declaration of a public policy first enacted as chapter 24, Laws 1874, and is clearly in the interest of public morals, and tends to the protection of those dealing with corporations. Most of the corporations created under the laws of this state have no fund or capital which their creditors can reach, except that derived from the issuance or sale of their stock; and, if this law be strictly followed in every case, corporations will not get credit upon the false pretense of having a large paid-up capital, when in fact a small percentage of the par value of the stock issued has ever come into the treasury of the company. The law is undoubtedly a salutary one, and its violation is clearly an illegal act, though no punishment is imposed by the statute for its violation. . . .' But the citation of authorities is unnecessary. The language of the constitution is clear. Plaintiffs could maintain this action only by showing that they were shareholders and vested with contract rights, of which the stock certificates issued to them were the evidence, which they could enforce against the corporation itself. This they have utterly failed to do. On the

contrary, by the express allegations of the complaint it appears that they acquired the stock, not only in fraud of the rights of the corporation, but in express violation of the constitutional mandate of the state, and of the provisions of the law under which the corporation was organized. The stock held by them is fictitious, within the meaning of the constitution, and no rights can be predicated upon it, either in law or equity. The bill was therefore properly dismissed as to them."

Idaho has a constitutional provision to the effect that, "No corporation shall issue stock or bonds, except for labor done, services performed or money or property actually received, and all fictitious increase of stock or indebtedness shall be void."

The constitution of the state of Illinois, contains a provision that, "No railroad corporation shall issue any stock or bonds except for money, labor or property actually received and applied to the purpose for which the corporation is created," and that "All stock dividends and all fictitious increase of capital stock or indebtedness of such corporations shall be void." This constitutional provision has been construed in the following cases: *Peoria R. Co. v. Thompson*, 103 Ill. 187; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *People v. Sterling, etc. Co.*, 82 Ill. 457; *Siegel v. Andrews & Co.*, 181 Ill. 350, 54 N. E. 1008; *Sprague v. National Bank*, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17; *Foot v. Ill. Bank*, 194 Ill. 600, 62 N. E. 834.

In the case of *Railroad Co. v. Thompson*, *supra*, the court says the object and purpose of such a constitutional provision, "was to prevent reckless and unscrupulous speculators under the guise or pretence of building a railroad or accomplishing some other legitimate corporate purpose, from fraudulently issuing and putting upon the market, bonds or stocks that do not and are not intended to represent money or property of any kind, either in possession or expectancy, the stock or bonds in such case, being entirely fictitious." This court also says in *Sprague v. National Bank*, *supra*, "If an Illinois corporation issues its shares of stock in exchange for the property and effects of a foreign corporation, having the same amount of capital stock, and assumes the latter's obligations, under an agreement that the property shall be received at an agreed price, in excess of its value, and equal in amount to the capital stock of each corporation, the stock of the Illinois company will, as against creditors, be deemed paid only to the extent that the fair actual value of the property received exceeds the amount of the indebtedness assumed."

In Kentucky, the constitution provides, "No corporation shall issue stock or bonds except for an equivalent in money paid or labor done, or property actually received and applied to the purposes for which said corporation was created, and neither labor nor property shall be received in payment of stock or bonds at a greater

value than the market price at the time the said labor was done or property delivered, and all fictitious increase of stock or indebtedness shall be void." The Federal court has held that under this constitutional provision a corporation could issue stock or bonds for a price less than the par value of such stock or bonds. *Altenberg v. Grant*, 85 Fed. 345.

In Missouri, the constitution provides that no corporation has the power "To issue stock or bonds except for money paid, labor done, or property actually received, and all fictitious increase of stock or indebtedness shall be void." The supreme court of Missouri, has on several occasions construed this constitutional provision, which provision is also embodied in the statute of that state. *Garrett v. Kansas City Coal Min. Co.*, 113 Mo. 330, 20 S. W. 965, 35 Am. St. Rep. 713; *Van Cleve v. Berkey*, 143 Mo. 109, 44 S. W. 743, 42 L. R. A. 592; *State v. Hogan*, 163 Mo. 43, 63 S. W. 378; *Chickle v. Watts*, 94 Mo. 410, 7 S. W. 274; *Berry v. Rood*, 67 S. W. (Mo.) 644; *McClure v. Paducah*, 94 Mo. App. 567; *First Natl. Bank v. Rockefeller*, 195 Mo. 15, 93 S. W. 761; *Scott v. Abbott*, 160 Fed. 573.

In the *Van Cleve v. Berkey* case, the supreme court of Missouri reviews at length the former decision of that court and comes to the conclusion that, "It is impossible to escape the conviction that in this state, whatever may be the case in some of the other states, the 'American trust doctrine,' as suggested by Mr. Justice Harlan, has indeed been reinforced by its constitution and statutes and that the proposition that the stock of a corporation must be paid for 'in meal or in malt'—in money or in money's value—is not a mere figure of speech, but really has the significance of its terms; it may be paid for in property, but in such case the property must be the fair equivalent in value to the par value of the stock issued therefor; that it is the duty of the stockholders to see that it possesses such value; that when a corporation is sent forth into the commercial world, accredited by them as possessed of a capital in money, or its equivalent in property, equal to the par value of its capital stock, every person dealing with it, unless otherwise advised, has a right to extend credit to it on the faith of the fact that its capital stock has been so paid for, and that the money, or its equivalent in property, will be forthcoming to respond to their legitimate demands—in short, that it is the duty of the stockholder, and not the creditor, to see that it is so paid."

Again in the case of *Garrett v. Kansas City Coal Min. Co.* where an attempt was made to transfer to the corporation an option on certain lands at an exorbitant and fictitious price the court says, "A party to a contract by which a large amount of paid-up capital stock in a corporation, to be afterwards organized for the development of certain lands, is to be issued to him in exchange for his equitable rights in options on those lands, and for his services in

promoting the corporation, cannot procure the enforcement of such contract, where it is apparent on the face of the instrument that his interest in the land and his services, when taken together, are nothing like a fair equivalent for the face value of the stock which he is to receive. Such a contract contravenes the express provisions of the constitution and statutes of Missouri, as well as the general policy of the law, requiring that the subscribers to corporate stock should pay in money or money's worth."

The decision reached by the supreme court of Missouri is criticised by Mr. Cook in his work on corporations, section 47. However, it must be said that if the language of the constitutional provision of the state of Missouri has any force or effect, or means anything at all, the construction placed thereon by that court is eminently correct. We suggest this, not in the spirit of criticism of Mr. Cook, but in the spirit of encouragement of the supreme court of Missouri, being moved by the remarks of that court in *Colonial Trust Co. v. McMillan* which are as follows, "The trial judge found the stock to be what is known as 'watered stock.' That it was such, and issued without value received, is beyond question on the facts disclosed by this record. That corporations created to be the owners of public utilities should be born into a sham and crippled life, and that there seems to be a call for more adequate safeguards against the itching temptation to circumvent our corporation laws by falsehood, whereby the ancient plan for making gain by 'watering stock,' conceived by the shrewd old patriarch, Jacob, in dealing with Laban (*Genesis, XXX, 30 et seq., q. v.*) is parodied and brought to blush, may concern the legislative branch of the government, but cannot be remedied by the courts except in sporadic cases, where some relief may be administered if the facts allow."

In Montana, the constitutional provision is, "No corporation shall issue stock or bonds except for labor done or services performed or money and property actually received; and all fictitious increase of stock or indebtedness shall be void." The supreme court of that state has had occasion to construe that constitutional provision; also the statute of that state, which is but a copy of the constitutional provision just quoted, in a mining corporation. The decision, it will be noted of *Kelly v. Clark*, follows Alabama and Missouri almost to the letter, with one exception. This case reviews at length, many authorities and considers this question from every standpoint. Hunt, J., in the course of his opinion says:

"We have viewed the matter from several standpoints. We have considered that it was a mine that the corporation was giving its stock for, and that the purposes of the company were mining; also, that the value of mining property is honestly often immoderately rated by those who estimate its probable value by some slight indication of an ore body of commercial worth. We have considered the showing made by the development work on the property

when the corporation was created. We have made every reasonable allowance for the unwarranted hopes of fortune that doubtless filled the minds of the defendant and his associates when they launched their enterprise upon the commercial world. We have even included allowances of fair profit to the promoter in trying to get at the fair value of the entire property as it was turned over to the company. But with all this there is nothing to contradict or shake the effect of the evidence from which it appears so clearly that there was absolutely nothing substantial upon which any man possessed of the most ordinary business capacity could have believed that \$7,500,000 was the reasonable value of a seven-eighths interest in the Fourth of July Mine. It must, therefore, stand as true that the property which the corporation received from Pardee as full payment for the stock was worth only \$125,000 when turned over to the company." And again in the same case: In the expression of the foregoing views of our own and those adopted by us from other courts, we do not mean to be understood as going to the extent of holding that a stockholder may be successfully charged by a creditor of a corporation as a holder of unpaid stock where the property given in exchange for the stock does not eventually prove to be as valuable as it was believed to be at the time of the transfer, nor that unwise judgment or indiscretion alone are sufficient. The judgment of men is too apt to be erroneous in relation to the valuations of property. This is especially true in new countries, where mining excitements frequently prevail, and values fluctuate rapidly and to an unusual extent. An honest mistake of judgment would seem to be a complete defence to such an action but no such feature is presented in the case under consideration. Good faith in the valuation put upon the property is what the law demands, and all that it demands. By 'good faith' is meant actual belief in the value put upon the property—the belief that a prudent and sensible business man would hold in the ordinary conduct of his own business affairs. Beliefs based upon visionary speculative hopes unwarranted by existing conditions or facts, and without reasonable evidence from the then present appearances, are not such beliefs as will relieve the shareholders. Such is the true rule, we think, and such is the one that the law intends shall be applied.

Higher authority than the statutes also exists to prohibit a corporation issuing stock except for property actually received. The constitution of the state, section 10, article 15, provides as follows: "No corporation shall issue stocks or bonds, except for labor done, services performed, or money and property actually received; and all fictitious increase of stock or indebtedness shall be void." "The stock of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding a majority of the stock first obtained at a meeting held after at least thirty days' notice given in pursuance of law."

In Pennsylvania the constitutional provision declares that, "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void." *Finletter v. Acetylene Light, Heat & Power Co.*, 64 Atl. 429; *American Tube & Iron Co. et al. v. Hays et al.*, 165 Pa. 489, 30 Atl. 936; *New Castle R. Co. v. Simpson*, 21 Fed. 533; *Woodbury v. Alleghany, etc. R. Co.*, 72 Fed. 379; *Hoffman v. Bloomsburg, etc. Co.*, 157 Pa. St. 174, 27 Atl. 564; *Guarantee, etc. Co. v. Dilworth Coal Co.*, 84 Atl. 516.

An examination of these authorities from the supreme court of Pennsylvania will show that the constitutional provision above quoted has been practically if not wholly and completely ignored by this court. It would seem under the rulings of this state, that the cost of the property transferred to the corporation for its stock is no measure of what the stock represents, and if a greater sum than the actual value of the company's property is paid, this court cannot see how the public is affected by the exaggerated estimate.

"In passing upon the legality of an issue of \$500,000 of stock for a road that had just been sold under a mortgage for \$100,000 the court said in *Commonwealth v. Central Passenger Ry.*, 52 Pa. St. 506, 515 (1886): 'In all such cases the determination of the amount of stock must be an arbitrary adjustment. As we have said, the cost of the property is no fair measure of what the stock represents, and if the real value be adopted as the standard, it is no standard at all. It varies with the estimates of witnesses, and the franchises are incapable of valuation. . . . If that was a sum greater than the actual value of the company's franchises and property, as it was greater than the cost, we are unable to see how the public was affected by the exaggerated estimate.'" (Quoted from *Cook on Corporations* [5th Ed.] § 47.)

This court expresses even more liberal views upon this question in *American Tube & Iron Co. et al. v. Hays*, *supra*; also in the late case of *Finletter v. Acetylene Light, Heat & Power Co.*

In Texas, section 6 of article 12 of the constitution provides: "No corporation shall issue stock or bonds except for money paid, labor done, or property actually received." In *O'Bear-Nester Glass Co. v. Antiexplor. Co.*, 101 Tex. 431, 108 S. W. 967, 130 Am. St. Rep. 865, the court says, "The purpose of the convention in enacting that provision of the constitution was to secure creditors as well as stockholders of corporations against the practice which was too common of corporations issuing fictitious stock and stock upon an insufficient consideration, whereby the actual capital was much less than the amount represented by the shares issued and sold by the corporation."

In Washington the constitutional provision is: "Corporations shall not issue stock except to bona fide subscribers therefor, or their assignees; nor shall any corporation issue any bond or other obli-

gation for the payment of money, except for money or property received, or labor done. . . . All fictitious increase of stock or indebtedness shall be void."

While in none of the following cases is the constitutional provisions above quoted especially referred to, they nevertheless show the position of the supreme court of Washington upon this question. *Turner v. Bailey*, 12 Wash. 634, 42 Pac. 115; *Adamant Mfg. Co. v. Wallace*, 16 Wash. 614, 48 Pac. 415; *Manhattan Trust Co. v. Seattle Coal Co.*, 19 Wash. 493, 53 Pac. 951; *Kroenert v. Johnson*, 19 Wash. 96, 52 Pac. 605; *Dunlap v. Rauch*, 24 Wash. 620, 64 Pac. 807; *Davies v. Ball*, 116 Pac. 833.

An examination of these cases will disclose the fact that the supreme court of the state of Washington has changed its rule once or twice. The holding in *Adamant Mfg. Co. v. Wallace* is to the effect that: "The corporation must be in the actual condition which it represents itself to be in financially. If it were allowed to hold itself out as having a capital stock of \$100,000 when in reality the capital stock which is and must be, under the theory of the law, assets in the hands of the corporation, is worth only one half that amount, the corporation is to that extent doing business under false colors and is obtaining credit upon the faith of an asserted estate, which is purely fictitious, and where by any arrangement between the shareholders of the corporation, the stock is issued as fully paid up when in fact it has not been paid to the full amount of its face value, but has been paid in property of a fictitious or inflated value, a court of equity will compel a payment by the stockholder for the benefit of the creditor, who has dealt with the corporation relying upon the asserted value of its assets to the full amount or face value of the stock."

It is to be noted that in the *Manhattan Trust Co.* case: "The capitalization of a coal mining company at \$5,000,000 is not shown to be fraudulent by the fact that the property of such corporation consisted of coal lands purchased by the promoters of the corporation for a sum less than \$100,000 where the grantors did not know the full value of the land and some sold for less than they believed it worth for the purpose of developing that section of the country, and estimates obtained by the promoters showed that there were more than 10,000,000 tons of coal in the land, which could be put on the market at a profit of from one to two dollars per ton."

However, whatever inconsistencies may appear in these cases, were cleared up in the case of *Dunlap v. Rauch*, in which the supreme court of Washington re-establishes the doctrine announced in the *Adamant* case, in this language: "While there has been some conflict in the expressions of this court as to the effect of payment of capital stock in property, the most frequent and best considered expressions approve the rule stated in *Adamant Mfg. Co. v. Wallace*, *supra*; that is, in substance, that the subscription to capital

stock must be paid in money or money's worth, and that the estimate of the value placed upon the property by the stockholders of the corporation is not conclusive upon the courts."

The Wisconsin statute provides, "No corporation shall issue any stock or certificate of stock except in consideration of money or labor, or property estimated by its true money value actually received by it, equal to the par value thereof; nor any bonds or other evidences of indebtedness except for money or for labor or property estimated at its true money value actually received by it, equal to 75% of the par value thereof, and all stocks and bonds issued contrary to the provisions of law and all fictitious increase of the capital stock of any corporation shall be void." (Ch. 24 Laws of 1874—Laws of 1907, page 410.) The supreme court of Wisconsin has had occasion to construe the laws of that state in *Clarke v. Lincoln Lumber Co.*, 59 Wis. 655, 18 N. W. 492; *First Ave. Land Co. v. Parker*, 111 Wis. 1, 86 N. W. 604, 87 Am. St. Rep. 841; *Mouray v. Farmers' L. & T. Co.*, 76 Fed. 38; *Gogebic Inv. Co. v. Iron Chief Min. Co.*, 78 Wis. 427, 47 N. W. 726, 23 Am. St. Rep. 417; *Heinze v. S., etc. Co.*, 109 Wis. 99, 85 N. W. 145.

Taylor, J., in *Clarke v. Lincoln Lumber Co.*, *supra*, says: "The contract for the sale and purchase of the stock was clearly void under this statute. The statute was a declaration of a public policy first enacted as ch. 24, laws of 1874, and is clearly in the interest of public morals and tends to the protection of those dealings with corporations. Most of the corporations created under the laws of this state have no fund or capital which creditors can reach except that derived from the issuance or sale of their stock, and if this law be strictly followed in every case, corporations will not get credit upon the false pretense of having a large paid up capital, when in fact a small percentage of the par value of the stock issued has ever come into the treasury of the company. The law is undoubtedly a salutary one and its violation is clearly an illegal act, though no punishment is imposed by the statute for its violation."

First Avenue Land Co. v. Parker, *supra*, was an action brought by the corporation against the bondsman of the secretary to recover the value of certain issues of stock, which had been issued by the secretary and delivered without consideration. The stock afterwards passed into the hands of innocent purchasers for value. The question turns on the validity of the stock and upon this question the court says:

"Stock certificates are void in the hands of an innocent holder if they were issued on the surrender of other certificates issued without any consideration in money or property, and the statutes of the state declare that stock so issued is void. The corporation cannot be estopped from denying the validity of such stock."

These constitutional provisions have on several occasions been before the supreme court of the United States, as well as in several

of the Federal courts. *Memphis, etc. R. Co. v. Dow*, 120 U. S. 287, 30 Law. Ed. 595; *White Water Valley Canal Co. v. Vallette*, 21 Howard, 424, 16 Law. Ed. 154; *R. R. Co. v. Howard*, 7 Wall. 413, 19 Law. Ed. 117; *Atl. Trust Co. v. Woodbridge C. & I. Co.*, 79 Fed. 842; *William Firth v. S. C. Loan, etc. Co.*, 122 Fed. 569; *Natl. Fndry. Wks. v. Oconto Water Co.*, 52 Fed. 29.

"The prohibition against the issuing of stock," says the United States supreme court in *Memphis, etc. R. Co. v. Dow*, "or bonds except for money or property actually received or labor done and against the fictitious increase of stock or indebtedness, was intended to protect stockholders against spoliations and guard the public against securities that were absolutely worthless. One of the mischiefs sought to be remedied, is the flooding of the market with stocks and bonds that do not represent anything of substantial value." The courts have experienced much difficulty in determining what is and what is not property or labor within the meaning of these constitutional provisions, or in other words, what is and what is not, fictitious stock, under these provisions. The law is settled beyond doubt that where a constitutional provision or statute provides that the stock shall be paid for at the par value thereof and is void in the event that it is not done, it must be paid for at its par value. *Altenberg v. Grant*, 85 Fed. 345.

However, the law is well and generally settled that the sale need not be for the par value of the stock. In other words that the stock may be sold for less than par, without violating the constitutional provisions under discussion. *Stein v. Howard*, 65 Cal. 616, 4 Pac. 662; *Railroad Co. v. Thompson*, 103 Ill. 187; *Mathias v. Pridham*, 1 Tex. Civ. App. 58, 20 S. W. 1015; *Brown v. Duluth, etc. Ry. Co.*, 53 Fed. 889; *Continental Trust Co. v. Toledo, etc. Ry. Co.*, 82 Fed. 642; *Memphis, etc. R. R. Co. v. Dow*, 120 U. S. 287, 30 Law. Ed. 595.

Again, the law is well settled that the corporation may issue its stock in exchange for any kind of property that it might lawfully purchase under its articles of incorporation. Thus, the good will of the business; a patent; an option on a mine; or other property, have been held to be property within the meaning of the law. Generally speaking the application of these constitutional provisions is confined to transactions where the corporation purchases property for stock in the corporation. However it is not necessarily confined to stock issuance, but applies with equal force to the issuance of bonds, and what has heretofore been said respecting the issuance of stock, usually applies with equal force and effect to bonds issued by the corporation. A corporation may pledge its bonds as collateral for a loan for less than the par value thereof. *White Water Valley Canal Co. v. Vallette*, 21 How. 414, 16 Law. Ed. 154.

They may be even issued and sold for less than par. *Gamble v. Queens County Water Co.*, 123 N. Y. 91, 25 N. E. 201, 9 L. R. A. 527;

Mr. Thompson, in his able article in Cyc.,⁸⁴ says, "Under such a constitutional provision, persons to whom corporate shares are issued for which they do not pay, or agree to pay anything, do not thereby become shareholders of the corporation in any sense, and

North Side R. R. Co. v. Worthington, 88 Tex. 562, 30 S. W. 1055, 53 Am. St. Rep. 778; Wm. Firth Co. v. S. C. Loan, etc. Co., 122 Fed. 569.

So too, it has been held that the issuing of bonds as security in excess of the debt secured, is not a fictitious issue or sale of bonds within the constitutional provisions hereinbefore discussed. *Dexter v. McClellan*, 116 Ala. 37, 22 South. 461.

Commenting upon the question of issuing stock and bonds and disposing of the same for less than the par value thereof, the supreme court of Alabama in *Nelson v. Hubbard*, 96 Ala. 238, 11 South. 428, 17 L. R. A. 375, says:

"The constitutional provision in question operates to invalidate evidences of indebtedness, when there is in fact no debt; to require every issue of stocks or bonds of private corporations to represent substantial values received by the corporations; to impose upon those charged with the disposition of corporate securities the duty to procure therefor a fair and reasonable equivalent in money, labor, or property actually contributed to the corporation. Courts of the highest authority, which have considered the effect of such provisions, have not construed them, when not fortified by more stringent statutory requirements, as invalidating issues of stocks and bonds in exchange for money, property, or labor, upon such terms as the corporate authorities, in the fair exercise of their judgment and discretion, may deem proper, though the amount received therefor was less than the face value of the securities. The negotiation of bonds must be a real transaction carried through to promote legitimate corporate purposes, and not a mere trick or device to evade the law, and impose greater obligations upon the corporation than there is any occasion for it to assume in order to obtain the consideration received thereof. Issues of stocks and bonds have been sustained under constitutional or statutory provisions of the same import as the one under consideration, when they were disposed of for the best price that could be obtained, though for considerably less than their face value. *Railroad Co. v. Dow*, 120 U. S. 287, 7 Sup. Ct. Rep. 482, 30 Law. Ed. 595; *Peoria, etc. R. Co. v. Thompson*, 103 Ill. 187; *Stein v. Howard*, 65 Cal. 616, 4 Pac. 662; *Handley v. Stutz*, 139 U. S. 417, 11 Sup. Ct. Rep. 530, 35 Law. Ed. 227; *Clark v. Bever*, 139 U. S. 96, 11 Sup. Ct. Rep. 469, 35 Law. Ed. 88; *Fogg v. Blair*, 139 U. S. 118, 11 Sup. Ct. Rep. 476, 35 Law. Ed. 10."

⁸⁴ 10 Cyc. 444.

cannot sue as such" and again, "the possession of a share certificate issued without authority of the Board of Directors will convey no rights as against the corporation, in the absence of an estoppel, upon one who is not a purchaser of them in good faith for value." Mr. Clark in his work on corporations,⁸⁵ says, "In quite a number of states, it is provided in substance that no corporation shall issue stock except for labor done, services performed, or money or property actually received; and all fictitious increase of stock shall be void. If effect is given to the language of this statute, it seems clear that stock issued by a corporation without consideration at all, is absolutely void and the holders do not become stockholders at all for any purpose."

The supreme court of the state of Colorado says, "Any discussion of the terms and conditions upon which such contracts might be made at common law, is unnecessary in this state, because, by the organic law itself, the powers of bodies corporate in this respect are expressly declared." Section 9, of Article 15 of the Constitution provides that, "No corporation shall issue stock or bonds, except for labor done, services performed, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void." This constitutional provision has been embodied in Sections 251 and 340 of the statute relating to corporations. The meaning of the language of the constitution is clear and unmistakable. If stock or bonds are issued "except for labor done, services performed, or money or property actually received" such issue is in direct violation to the constitution and the statutes and *ipso facto* invalid. The constitution of the state of Illinois, relating to this subject is the same, in effect, as that of this state except that its operation is confined to railroad corporations. In the case of *Railroad v.*

⁸⁵ Clark on Corporations, 385.

Thompson,⁸⁶ this provision was construed. In that case, it was held that the object of section 13, article 11, of the present constitution, in providing that "no railroad corporation shall issue any stock or bonds except for money, labor or property actually received and applied to the purposes for which such corporation was created;" and that "all stock, dividends and other fictitious increase of the capital stock or indebtedness of such corporation, shall be void" was to prevent reckless and unscrupulous speculators, under the guise or pretense of building a railroad, or of accomplishing some other legitimate corporate purpose, from fraudulently issuing and putting upon the market, bonds and stocks that do not and are not intended to represent money or property of any kind, either in possession or in expectancy, the stock or bonds in such case being entirely fictitious.

A like statute of the state of Wisconsin was considered in the case of *Clark v. Lincoln Lumber Co.*⁸⁷ In the course of the opinion, Taylor, J., says: "The contract for the sale and purchase of the stock was clearly void under the statute. The statute was a declaration of the public policy first enacted as Chapter 24, Laws of 1874, and is clearly in the interest of public morals, and tends to the protection of those dealing with corporations. Most of the corporations created under the laws of this state have no fund or capital which their creditors can reach, except that derived from the issuance or sale of their stock; and if this law be strictly followed in every case, corporations will not get credit upon the false pretense of having a large paid up capital, when in fact a small percentage of the par value of the stock issued has ever come into the treasury of the company.

The law is undoubtedly a salutary one, and its viola-

⁸⁶ *Railroad v. Thompson*, 103 Ill. 187.

⁸⁷ *Clarke v. Lincoln Lumber Co.*, 59 Wis. 655, 18 N. W. 492.

tion is clearly an illegal act, though no punishment is imposed by the statute for its violation." To the same effect see.⁸⁸

Where directors cause watered stock to be issued to themselves, or "dummies" under their control, they are clearly liable to the corporation, or its creditors, for the actual value of the stock, or the corporation can maintain an action for cancellation of the stock. This liability attaches by reason of the fiduciary relation they sustain toward the corporation and its stockholders.⁸⁹ And where the director is also the promoter of the corporation he will be held liable in his capacity, both as director and promoter.⁹⁰ A few courts approve the idea of holding the directors personally liable even when stock is issued and sold to third persons, upon the theory that to issue watered stock is an *ultra vires* act.⁹¹

In the latter class of cases it will be found that the exact line of liability is very difficult to establish. However, if the act of issuing the watered stock is clearly beyond the powers of the directors, it would seem that they are liable even though done in good faith. Again, directors have been held liable for damages resulting from the issuance of watered stock, when it is represented as "full paid" stock.⁹² The law seems to be well

⁸⁸ First Ave. Land Co. v. Parker, 111 Wis. 1, 86 N. W. 604, 87 Am. St. Rep. 842; Clarke v. Lincoln Lumber Co., 59 Wis. 655, 18 N. W. 492; Kellerman v. Maier, 116 Cal. 416, 48 Pac. 377; Jefferson v. Hewitt, 103 Cal. 624, 37 Pac. 638; Beltman v. Steiner, 98 Ala. 241, 13 South. 87; Williams v. Evans, 87 Ala. 725, 6 South. 702, 6 L. R. A. 218; Perry v. Tuscaloosa Cotton Seed Oil Co., 93 Ala. 364, 9 South. 217; Coler v. Tacoma, 85 N. J. Eq. 347, 54 Atl. 413, 103 Am. St. Rep. 786.

⁸⁹ See subject "Contracts of Directors."

⁹⁰ See subject "Promoters."

⁹¹ London Trust Co. v. Mackenzie, 68 L. T. Rep. 380; Great Western, etc. v. Harris, 111 Fed. 38; Foster v. Seymour, 23 Fed. 65, 23 Blatchf. 107.

⁹² Cross v. Sackett, 6 Abb. Pr. 247; Re Gold Co., L. R. 11 Ch. D. 701.

settled in this country that when a person purchases stock, in the open market, in regular course of trade, and there is printed upon the face of the certificate "full paid" or words of the same import, the purchaser thereof cannot be subject to liability, as he need inquire no further than the face of the certificate itself.⁹³

On the other hand, where the purchaser buys stock purported to be full paid with full knowledge of the facts that the stock has never been fully paid, he is liable to the creditors for the unpaid balance.⁹⁴ Corporate creditors who contract with the corporation with full knowledge of the fact that the stock has never been fully paid, or paid with property or labor at an over valuation, or sold for cash below par, cannot complain.⁹⁵ It is to be noted in this regard that the supreme court of Illinois⁹⁶ takes the view that under their statute, the right of the creditor to enforce liability against one who has subscribed for stock in a corporation and has not paid his subscription in full, is not dependent, in any degree, upon the knowledge possessed by the creditor that such subscription was, or was not paid in full.

So, too, the supreme court of New Jersey in the late

⁹³ *In re Remington Auto. & Motor Co.*, 153 Fed. 345; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Rood v. Whorton*, 67 Fed. 434; *Brant v. Ehllen*, 59 Md. 1; *Dieterle v. Ann Arbor Paint, etc. Co.*, 143 Mich. 416, 107 N. W. 79; *Davies v. Ball* (Wash.), 116 Pac. 833.

⁹⁴ *Anheuser-Busch Brew. Ass'n v. Park Novelty Co.*, 120 Mo. App. 513, 97 S. W. 209; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *White v. Greene*, 70 N. W. 182; *Kelly v. Clark*, 21 Mont. 291, 53 Pac. 959, 42 L. R. A. 621, 69 Am. St. Rep. 668; *Davies v. Ball*, *supra*.

⁹⁵ *Lea v. Iron Belt Merc. Co.*, 147 Ala. 421, 8 L. R. A. (N. S.) 279, 119 Am. St. 93, 42 South. 415; *Bank of Ft. Madison v. Alden*, 129 U. S. 372, 32 Law. Ed. 725; *State, etc. v. Turner*, 111 Iowa, 664, 82 N. W. 1029, 53 L. R. A. 136; *Berry v. Rood*, 67 S. W. 644; *Colonial Trust Co. v. McMillan*, 188 Mo. 547, 87 S. W. 933, 107 Am. St. Rep. 335.

⁹⁶ *Sprague v. Natl. Bank of America*, 172 Ill. 149, 50 N. E. 19, 42 L. R. A. 606, 64 Am. St. Rep. 17.

case of *Easton Natl. Bank v. American Brick & Tile Co.*⁹⁷ holds that a creditor's knowledge that stock was improperly issued as full paid and as issued for property purchased, when the fact was otherwise is not sufficient to debar him from relief against the recipients of the stock. This case also holds, "That a stockholder, who participated actively in the transaction that resulted in an improper issuance of stock as 'issued for property purchased, and himself received a part of such stock, held not estopped from participating, as a creditor in proceedings taken to enforce the liability of delinquent stockholders, by the circumstance that their stock certificates were marked 'full paid' and 'issued for property purchased,' since the stockholders knew the fact to be otherwise." Where the contract purported to authorize the issuance of stock is fraudulent, no action is necessary to set such a contract aside before bringing suit upon the stockholders' liability. The supreme court of New Jersey in a recent case, commenting upon this question says: "Assuming the case showed a contract between the company and its stockholders, that the stock certificates should be issued as full paid and as for property purchased, and that this contract was in fact of such a character and made under such circumstances that it contravened the prohibition of the corporation act, it was not merely voidable but void. It had as little effect for any purpose as the contract that was before this court in *Volney v. Nixon* (N. J. E. & A.), 60 Atl. 189, and could not be laid hold of by either party as a ground of action or a ground of defense. No bill or other original proceeding was necessary to procure an adjudication of its nullity, and the court, on the petition originally filed by the receiver for

⁹⁷ *Easton Natl. Bank v. Am. Brick & Tile Co.*, 70 N. J. Eq. 732, 64 Atl. 917.

the purpose of enforcing the liability of the stockholders for the unpaid portion of their subscriptions, upon ascertaining the facts that rendered the so-called contract void, was at liberty to treat it as affording no obstacle to the relief prayed by the receiver."⁹⁸

Where the certificate of such stock recites upon its face that it is fully paid and non-assessable, it is not conclusive as against the creditors of such corporation.⁹⁹ The corporation cannot by any device, release the stockholders from liability attached by reason of unpaid subscriptions.¹⁰⁰ Before a creditor is permitted to sue the stockholder for his unpaid subscription, he should exhaust his remedy against the corporation.¹⁰¹ On the other hand, when the creditor of the corporation secures a judgment against it, the judgment is conclusive as against the stockholders, unless there is fraud, collusion, or want of jurisdiction.¹⁰² As we have heretofore noted, statutory liabilities cannot be limited either by contract or provisions in the articles of incorporation. Issuing stock in the form of dividends is now prohibited by law in some of the states.¹⁰³ However, legitimately done and not for the purpose of inflating stock, or some ulterior motive, no serious objec-

⁹⁸ *Easton Natl. Bank v. Am. Brick & Tile Co.*, 70 N. J. Eq. 732, 64 Atl. 1098.

⁹⁹ *See v. Heppenheimer*, 69 N. J. Eq. 36, 61 Atl. 843.

¹⁰⁰ *Hall v. Ala. T. & Implement Co.*, 143 Ala. 464, 39 South. 285; *Webb v. Rockefeller*, 195 Mo. 57, 93 S. W. 772, 6 L. R. A. (N. S.) 872.

¹⁰¹ *Hazelett v. Woodhead*, 27 R. I. 506, 63 Atl. 952.

¹⁰² *Town of Hinckley v. Kettle River, etc. Co.*, 80 Minn. 32, 82 N. W. 1088; *Warrington v. Ball*, 90 Fed. 464; *Choat v. Boyd*, 59 Kan. 682; *Hancock Natl. Bank v. Farnum*, 176 U. S. 640, 44 Law. Ed. 619; *Ball v. Reese*, 58 Kan. 614, 50 Pac. 875, 62 Am. St. Rep. 638; *Holland v. Duluth Iron Min. Co.*, 65 Minn. 324, 68 N. W. 50, 60 Am. St. Rep. 480; *Nichols v. Stevens*, 123 Mo. 96, 25 S. W. 578, 27 S. W. 613, 45 Am. St. Rep. 514; *Thompson v. Reno Sav. Bank*, 19 Nev. 103, 7 Pac. 68, 3 Am. St. Rep. 797.

¹⁰³ Ill. Constitution, art. 10, § 13; Mont. Constitution, art. 15, § 2; Wash., § 3697; Rem. & Ball. Ann. Codes and Statutes; Wis. Rvsed. statutes, § 1753.

tion can be found to this mode of issuing stock. On the contrary, both text book writers and courts have of late years encouraged it. While we do not advise or encourage the issuance of stock in the form of dividends, owing to the many opportunities for unfair dealings and ulterior motives, we see no objection, if legitimately and fairly issued. The supreme court of New York, has taken a broad and probably the correct view upon this question:

Stock dividends "could be declared by a corporation without violating its letter, its spirit, or its purpose;" and "there is no public policy which in all cases condemns such dividends." "No harm is done to any person, providing the dividend is not a mere inflation of the stock of the company, with no corresponding values to answer to the stock distributed." "So long as every dollar of stock issued by a corporation is represented by a dollar of property, no harm can result to individuals, or the public from distributing the stock to the stockholders."¹⁰⁴

However, such an issue must be fair, legitimate, and untainted with fraud or bad faith.¹⁰⁵

§ 59. **Assessable stock.**—The term assessable stock as here used must be distinguished from a "call." A "Call" strictly speaking has no application where the stock has once been fully paid or where it has been purchased from the corporation for less than its par value.¹⁰⁶ In *Scovill v. Thayer* the United States supreme court, where stock was sold to a purchaser for less than the par value thereof, held that as between the stockholder and the company the contract was a valid agreement, and the corporation could not repudiate this agreement and recover the full value of the stock. One

¹⁰⁴ *Williams v. Western Union Telegraph Co.*, 93 N. Y. 162.

¹⁰⁵ *In re Development Co.*, 86 L. T. Rep. 323.

¹⁰⁶ *Scoville v. Thayer*, 105 U. S. 143, 26 Law. Ed. 968.

of the inducements that has led to the multiplicity of private corporations has been the non-liability of stockholders for the debts of the corporation. Of course, when the stockholder purchases stock from the corporation at a price less than the par value thereof, where the stock has never been fully paid, under the trust fund doctrine, such stockholder is liable to the creditors of the corporation for the difference between the par value of the stock and the amount he has paid therefor. Where, however, the stock has been fully paid, in the absence of statutory authority, or of express power conferred by the articles of incorporation, there can be no assessments of such stock. In California the statute provides that, "The directors of any corporation formed or existing under the laws of this state, after one-fourth of its capital stock has been subscribed, may, for the purpose of paying expenses, conducting business, or paying debts, levy and collect assessments upon the subscribed capital stock thereof." Idaho and Montana have statutes identical with the California statute except that in Montana, the words, "after one-fourth of its capital stock has been subscribed," are eliminated. The statutes of a number of other states authorize the issuance of assessable stock.

The scope of this work does not permit a discussion of these various statutes. All of the authorities agree that the right to levy and collect assessments on corporate stock must come from the law or the charter, and can only be legally exercised in the manner provided by the law, or by the charter. These statutes are all strictly construed and must be followed with great care.¹⁰⁷ The reason for a strict construction in such

¹⁰⁷ *Northampton Mut., etc. Co. v. Stewart*, 39 N. J. L. 486; *Ruck v. Caledonia Sil. Min. Co.*, 6 Cal. App. 356, 92 Pac. 194; *San Bernardino Ice Co v. Merrill*, 108 Cal. 493, 41 Pac. 488; *Morris v. Metaline Land Co.*, 164 Pa. St. 326, 30 Atl. 240, 27 L. R. A. 305, 44 Am. St. Rep. 614; *Hughes v. Antietam Mfg. Co.*, 34 Md. 316; *Raht v. Min. Co.*, 18

case is, that the sale, if regular and founded upon a valid assessment, forfeits the stock; and equity has no power to relieve from such forfeiture.

§ 60. **Non-assessable stock.**—By far the greater percent of stock issued by corporations is non-assessable stock. The customary practice is to pay up the entire capital stock with property at the organization meeting and then donate to the treasury presumably enough stock to develop the enterprise to a dividend paying proposition. Where such stock has been fully paid in property, labor, or money, no assessments can be levied against it, with the exception that in the states of California and Minnesota the holders of such stock may be required to pay their proportion of the debts of the corporation. Notwithstanding such stock is usually sold for much less than its par value the contract is binding upon the corporation.¹⁰⁸

Utah, 290, 54 Pac. 889; *Rood v. Whorton*, 67 Fed. 434; *Bell v. Standard Q. Co.*, 146 Cal. 699, 81 Pac. 17; *Corcoran v. Sonora Min. & Mill. Co.*, 8 Idaho, 651, 71 Pac. 127; *Clise Inv. Co. v. Washington Sav. Bank*, 18 Wash. 8, 50 Pac. 575; *Budd v. Railway Co.*, 15 Ore. 413, 15 Pac. 659, 3 Am. St. Rep. 169.

¹⁰⁸ *Scoville v. Thayer*, 105 U. S. 14; 26 Law. Ed. 968.

CHAPTER X.

STOCKHOLDERS.

- § 62. Generally.
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- 64. Right to meet in stockholders' meeting.
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§ 62. **Generally.**—The American and English Encyclopedia of Law says, "A stockholder is one who holds membership in a corporation or joint stock-stock company by virtue of holding or owning one or more shares of its stock. In the United States the term is used synonymously with 'shareholder,' though the latter is less common, but in England the word shareholder is almost exclusively employed. Other terms often used in a sense closely approaching that of 'stockholder,' but distinguishable from it by certain shades of meaning, are 'corporator,' 'member,' and 'subscriber.' "

To be a stockholder in a corporation, a person, must of course own stock in the company, otherwise he cannot be a stockholder and is not entitled to the rights nor privileges of a stockholder. There may be instances where persons are entitled to represent the interests of stockholders the same as if the stockholder were pres-

ent personally; such, as a trustee, an executor, pledgee, etc. They are not, however, stockholders in the strict sense of the term but merely represent the interests of the real stockholder. A stockholder becomes such by a contract based upon a consideration.

It would seem that the sole test by which the question whether or not a person is a stockholder is, has he made such a contract with the corporation for its stock as is enforceable and can the corporation enforce the subscription agreement? In other words, the stockholder must be in a position to enforce his rights and compel the corporation to recognize him as a stockholder. The corporation must be able to enforce the stockholder's agreement. The fact that a person does not possess a stock certificate is immaterial.¹ On the other hand the fact that he does possess a stock certificate would not necessarily constitute him a stockholder.

§ 63. **Rights of stockholders generally.**—The rights of a stockholder are; to meet at stockholders' meetings; to participate in the profits of the business and to require that the property and funds shall not be diverted from their original purpose. If the corporation becomes insolvent, it is the right of the stockholders to have the property applied to the payment of its debts. The right to a certificate of stock, to transfer it on the books of the company; to inspect the books, records and papers of the company are incident or auxiliary to these rights.

Failure of the corporation to recognize any of these rights to a stockholder will give the stockholder a cause of action against the corporation at law or in equity according to the nature of the case. Any attempt by by-law provision or otherwise to abrogate these rights will prove ineffectual. It is one of the well recognized offices

¹ *Cotter v. Butts, etc. Co.*, 31 Mont. 129, 77 Pac. 509; *Glenn v. Rosborough*, 48 S. C. 272, 26 S. E. 611.

of the remedy by mandamus to enforce the plain rights of stockholders or members of corporations in the absence of any other adequate remedy.²

§ 64. Right to meet in stockholders' meeting.—The first great right incident to the holding of corporate stock and inseparable from such stock, is the right to meet in stockholders' meetings. Stockholders not only have an absolute right to attend such meetings, but are also entitled to notice thereof in the manner and form prescribed in the by-laws of the corporation.

Such stockholders are entitled to a vote and voice in all such meetings and ordinarily cannot be deprived thereof by by-law provisions. It is at such meetings that the stockholders of the corporation participate indirectly in the management of the affairs of the company, prescribe the general policy of the corporation; and generally see to it that the trust imposed upon the directors and officers have been faithfully fulfilled.

It must be remembered that the corporation is a separate and distinct entity from its stockholders. The very nature of corporate organization is such that the business must be conducted and carried on by and through agents called directors and officers, therefore stockholders as such, cannot directly participate in the actual management of the company, or interfere in such management, or with the property of the corporation. This right as we already have suggested is vested in the directors and officers, whose will and judgment confined to the legitimate objects and purposes of the corporation and done in good faith for the interest of the corporation are supreme and will not be interfered with by the courts.

² High on Extraordinary Legal Remedies, § 276; Clark & Marshall on Private Corporations, § 265; Purdy's Beach on Private Corporations, § 575.

§ 65. **Right to require that corporate property shall not be diverted from the original purpose.**—The stockholders have an unquestionable legal right to insist that the property and funds of the corporation shall not be diverted from their original purpose. That is, they cannot be diverted into a channel outside of the legitimate objects and purposes for which the corporation is formed. This is true notwithstanding the fact that a majority of the capital stock has an absolute right to control the corporate business.

“Officers of a corporation cannot, against the wishes of a single stockholder convey away the entire property from which the corporation derives its emoluments, and which is essential to the business purposes of its organization. The right of the stockholder in this regard is founded upon contract. He has invested his means upon an agreement with his fellow-corporators that they shall be devoted to the promotion of the general objects defined in the charter. He must yield to the will of the majority in whatever conforms to the tenor of this agreement, as being directed to the successful prosecution of the common enterprise. But, when asked to submit to a proceeding which effectually annihilates the enterprise and diverts his contribution into a channel never contemplated by him, the courts will protect him to the letter of his reserved rights.”³

§ 66. **Right to dividends.**—The primary object of a shareholder acquiring stock in a corporation is that he may receive an income from his investment. This is known as the dividend. Incident to the ownership of the stock is a legal right to the dividends or earnings of the corporation. As soon as a dividend is declared and ordered paid according to the statute, charter or by-

³ *Buford v. Packet Co.*, 3 Mo. App. 159; see also *Field v. Roanoke Inv. Co.*, 123 Mo. 613, 27 S. W. 635; *Knoxville v. Knoxville*, 22 Fed. 758. See chapter “Sale of Corporate Property.”

laws, it belongs to the stockholders.⁴ Until it is so declared, it belongs to the corporation.⁵

Dividends may be either in cash or property, or stock and bonds. They must in all cases, however, be declared and paid from the net earnings of the corporation and any attempt to declare or pay a dividend out of the capital stock will be illegal and, if paid, may be recovered.⁶ It is the duty of the directors to declare dividends when the earnings and profits of the corporation will warrant such dividends under the statute of the state, its charter and by-laws.⁷ However, the declaring of dividends in all cases is left to the sound discretion of such board of directors, and the courts will seldom interfere with this discretion unless there is some evidence of fraud and bad faith.⁸ Of course, where an attempt is made to issue or pay out an illegal dividend, the stockholders are entitled to an injunction.⁹

As we have already suggested the accumulated profits belong to the corporation until a dividend has been regularly and legally declared by the directors. Such dividends then become and are the property of the shareholders, and, therefore, it necessarily follows that a person is not entitled to participate in dividends declared after his stock has been transferred, although

⁴ *Cratty v. Peoria, etc. Ass'n*, 219 Ill. 516, 76 N. E. 707; *Steele v. Island, etc. Co.*, 47 Ore. 293, 83 Pac. 783.

⁵ *Bryan v. Sturgiss Natl. Bank (Tex.)*, 90 S. W. 704.

⁶ *Siegman v. Electric, etc. Co. (N. J.)*, 65 Atl. 910; *Cratty v. Peoria, etc. Ass'n*, 219 Ill. 516, 76 N. E. 707; *Mills v. Hendershot*, 70 N. J. Eq. 258, 62 Atl. 542; *Goodnow v. Am. Writing Paper Co. (N. J.)*, 69 Atl. 1014; *Siegman v. Electric, etc. Co.*, 140 Fed. 117.

⁷ *Grant v. Ross*, 100 Ky. 44, 37 S. W. 263.

⁸ *Hunter v. Roberts, etc. Co.*, 83 Mich. 63, 47 N. W. 131; *Cratty v. Peoria, etc. Ass'n*, 219 Ill. 516, 76 N. E. 707; *Bryan v. Sturgiss Natl. Bank (Tex.)*, 90 S. W. 704.

⁹ *Mobile, etc. R. Co. v. Tennessee*, 153 U. S. 486; *Coquard v. Natl., etc.*, 171 Ill. 480, 49 N. E. 563.

such dividends may have been earned before such transfer.¹⁰

Ordinarily a corporation is safe in paying dividends to such shareholders as appear of record on the books of the corporation at the time the dividend was declared.¹¹ There can be no discrimination between stockholders of the same class in declaring and distributing the dividends, but all stockholders must be treated equally and fairly.¹² "After a stockholder acquires stock in a corporation, the record of a by-law, providing for the payment of dividends upon all the stock, cannot be changed so as to deprive the stockholder of dividends on unpaid stock, although the change was to correct a clerical error in the record of the by-law as actually passed."¹³

Where a stockholder is indebted to the corporation for stock or otherwise, at the time the dividend is declared and ordered paid, the corporation may apply such dividend to the payment of such claim and if sued for the dividend is entitled to a setoff.¹⁴

§ 67. Right to property on winding up and dissolving the corporation.—Where the business affairs of the corporation are wound up and the corporation is dissolved, the property and funds or the receipts thereof must be applied first to the debts of the corporation. The creditors, it will be remembered have preferred rights to the stockholders. That is, all claims and debts against the corporation must be paid before the stockholder is entitled to any part of the corporate assets when it is wound up and dissolved. Whatever may be left after the legal debts and obligations have been disposed of

¹⁰ *Corgan v. Lee Coal Co.*, 218 Pa. 386, 67 Atl. 655.

¹¹ *Steel v. Island, etc. Co.*, 47 Ore. 293, 83 Pac. 783.

¹² *Cratty v. Peoria, etc. Ass'n*, 219 Ill. 516, 76 N. E. 707.

¹³ *Gellerman v. Atlas Foundry Mfg. Co.*, 45 Wash. 114, 87 Pac. 1059.

¹⁴ *Kennedy v. Citizens' Natl. Bank*, 128 Iowa, 561, 104 N. W. 1021; *King v. Patterson, etc. Co.*, 29 N. J. L. 504.

and paid, belongs, of course, as a matter of right, to the stockholders of the corporation in proportion to the number of shares owned and held by them in such company. The property and assets are usually distributed to the stockholders under an order of court.

§ 68. **Right to certificate of stock.**—A few of the states have statutes requiring the corporation to issue to its stockholders certificates of stock signed by the president and usually by the secretary of the corporation, which certificate of stock shall certify the number of shares to which the holder thereof is entitled.¹⁵

The statute of Colorado provides that each certificate of stock issued by a mining company shall have plainly printed on the face thereof the word "assessable" or "non-assessable" as the case may be. In the absence of statute, it is doubtful if the corporation could be compelled to issue a certificate of stock to the stockholder, as a certificate of stock is not necessary to the ownership of the stock, unless however, the corporation has obligated itself to issue a certificate of stock by an established custom. The question of certificates of stock is fully discussed elsewhere in this book.

§ 69. **Right to inspect books.**—A stockholder of a corporation has a right at all reasonable times within business hours, for proper purposes, to inspect and examine the books and records of the corporation, so long as his purpose is to inform himself in the interest of the corporation, as to the manner in which the corporate affairs are being conducted and carried on.

The law is well settled that the right to examine and inspect the books and records of the corporation is a common law right.¹⁶ It is to be noted also that in addi-

¹⁵ Montana, New Jersey, California and Idaho.

¹⁶ *State ex rel. v. Pacific Brew., etc. Co.*, 21 Wash. 452, 58 Pac. 584, 47 L. R. A. 208; *Harkness v. Guthrie*, 27 Utah, 248, 75 Pac. 624, 107

tion to this common law right, nearly all of the states now have statutes requiring corporations to keep their books open for inspection of the stockholders during the usual business hours of the day of every day except Sundays or legal holidays.¹⁷

The supreme court of the United States has indicated in *Guthre v. Harkness*, *supra*, that statutes giving the stockholders right to examine and inspect the books of the corporation are to be construed as merely declaratory of the common law. The weight of authority however, as will be more fully pointed out, goes to the extent of holding that under the statute the stockholders have an absolute right to the examination, while under the common law rule, his right in certain respects is limited.

The supreme court of Alabama in *Foster v. White*,¹⁸ commenting upon this question, says: "We do not concur in the proposition that the statute is merely declaratory of the common law. . . . The statute was enacted in view of the restrictions and limitations placed by the common law upon the exercise of the

Am. St. Rep. 664; *State v. St. Louis Transit Co.*, 124 Mo. App. 111, 100 S. W. 1126; *Varney v. Baker*, 194 Mass. 239, 80 N. E. 524; *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Guthre v. Harkness*, 199 U. S. 148; *O'Hara v. Natl., etc. Co.*, 69 N. J. L. 198, 54 Atl. 241.

¹⁷ The statutes of California, Montana, Idaho, provide that in addition to keeping a record of all business transacted, that all corporations for profit, must keep a book, to be known as the stock and transfer book, in which must be kept a record of all stock; the names of the stockholders, or members, alphabetically arranged; instalments paid or unpaid; assessments levied and paid or unpaid; a statement of every alienation, sale, or transfer of stock made, date thereof, by and to whom; and all such other records as the by-laws prescribe.

Such stock and transfer book must be kept open to the inspection of any stockholder, member, or creditor. Nearly every state now has statutes permitting the stockholders and creditors to inspect the books of the corporation.

¹⁸ *Foster v. White*, 86 Ala. 467, 6 South. 88.

right; and the purpose is to protect small and minority stockholders against the mismanagement and faithlessness of agents and officers, by furnishing mode and opportunity to ascertain, establish and maintain their rights, and to intelligently perform their corporate duties. Its terms are clear and comprehensive, and afford narrow room for construction. It was intended to enlarge and disembarrass the exercise of the right, rendering it consistent and co-extensive with the stockholder's right as a common owner of the property, books and papers of the corporation, and with the duties and obligations of the managing officers, as agents and trustees. The only express limitation is, that the right shall be exercised at reasonable and proper times. The implied limitation is, that it shall not be exercised from idle curiosity or for improper or unlawful purposes. In all other respects the statutory right is absolute."

The supreme court of California commenting upon this question in *Johnson v. Langdon*,¹⁹ says, "At common law the stockholders of a corporation had the right to examine, at reasonable times, the records and books of the corporation. But the writ would not issue as a matter of course to enforce a mere naked right, or to gratify mere idle curiosity, but it was necessary for the petitioner to show some specific interest at stake rendering the inspection necessary, or some beneficial purpose for which the examination was desired. But the great weight of the American authorities is to the effect that where the right is statutory it is not necessary for the petitioner to aver or show the purpose or object of the inspection. Neither is it any defense to allege that the objects and purposes are improper, and that the petitioner desires to injure the business of the corporation. The clear legal right given by the constitution

¹⁹ *Johnson v. Langdon*, 135 Cal. 624, 67 Pac. 1050, 87 Am. St. Rep. 156.

and the statute cannot be defeated by stopping to inquire into motives. If this were so, the stockholder would be driven from the certain definite right given him by the statute to the realm of uncertainty and speculation. * * * The statute is founded upon the principle that the shareholders have a right to be fully informed as to the conditions of the corporation, the manner in which its affairs are conducted, and how the capital to which they have contributed is employed and managed. The shareholder is not required to show any reason or occasion for making the examination. Nor can he be met with the defense that his motives are improper. It may be conceded that cases may arise in which a small stockholder, largely interested in some other corporation, desires the information for improper purposes. But we cannot presume such purpose or motive, nor can we allow it as a defense to an application for writ of mandate. We must presume that the owner of a part of the stock of a corporation is interested in its welfare and prosperity; that he desires to know the condition of its business affairs, for the same reason that any prudent business man would desire to know the condition and management of his private affairs. If the corporation might be injured in certain cases, it is no more than is often the case with private owners of property. The law will presume any damage done by a stockholder to the corporation of which he is a member can be recovered in an action at law. When a case arises in which the stockholder has obtained information of a secret nature, and furnished it to a rival company or corporation, to the injury and damage of the corporation from whom the information is obtained, it will be time to deal with it. We do not think public policy demands that such defense can be made to a clear legal right."

It will thus be seen that the distinction pointed out

by the courts under the common law right and the statutory right is that under the common law the right to inspection was restricted and limited in certain respects. That is, under the common law rule it was necessary to allege and aver some specific interest or reason rendering inspection necessary, or some beneficial purpose for which the examination was desired,²⁰ while under the statutes granting absolute right of inspection the purpose or object in demanding such inspection is immaterial.²¹

While the statutory right is an absolute right, yet it is believed that the interest of the corporation will be properly protected. Under the above authority, it would seem that the power that gives the right of inspection will also prevent the stockholders from abusing it. The supreme court of Alabama in *Foster v. White*, *supra*, in construing one of these statutes says: "The only express limitation is that the right shall be exercised at reasonable and proper times. The implied limitation is that it shall not be exercised for idle curiosity or for improper or unlawful purposes."

The supreme court of Missouri in a recent case, *State v. St. Louis Transit Co.*,²² while taking the position

²⁰ *Johnson v. Langdon*, 135 Cal. 624, 67 Pac. 1050, 87 Am. St. Rep. 156; *Harkness v. Guthrie*, 27 Utah, 248, 75 Pac. 624, 107 Am. St. Rep. 664.

²¹ *Hub. Const. Co. v. N. E., etc. Co.*, 74 N. H. 282, 67 Atl. 574; *Wyoming Coal Min. Co. v. State*, 15 Wyo. 97, 87 Pac. 337; *State v. Pac. Brew. Co.*, 21 Wash. 451, 58 Pac. 584, 47 L. R. A. 208; *Foster v. White*, 86 Ala. 467, 6 South. 88; *Cincinnati Volksblatt v. Hoffmeister*, 62 Ohio St. 189, 78 Am. St. Rep. 707, 48 L. R. A. 732, 56 N. E. 1033; *In re Steinway*, 159 N. Y. 250, 53 N. E. 1103, 45 L. R. A. 461; *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Bevier v. U. S. Wood Preserve Co. et al.*, 69 Atl. 1008.

²² *State v. St. Louis Transit Co.*, 124 Mo. App. 111, 100 S. W. 1126; *State v. Einstein*, 46 N. J. L. 479; *State v. Pan American Co.*, 61 Atl. 398; *Legendre v. New Orleans Brew. Co.*, 45 La. Ann. 669, 12 South. 837, 40 Am. St. Rep. 243; *Bruning v. Hoboken Print. Co.*, 67 N. J. L. 119, 50 Atl. 906; *Phoenix Iron Co. v. Commonwealth*, 113 Pa. St. 563, 6 Atl. 75; *Lyon v. Am. Screw Co.*, 16 R. I. 472, 17 Atl. 61.

that the statutory right of inspection is an absolute right and cannot be infringed upon nor taken from the stockholder, yet it is held that it cannot be exercised for wrongful or unlawful purposes.

In *Weinhenmayer v. Bitner*, the supreme court of Maryland, commenting upon this question says: "The right is given to him as a stockholder by statute and is absolute and not made to depend upon any circumstance but the ownership of the stock. It is easy to see that there might be good reasons for refusing an application; for instance, if it were made for some evil, unlawful or wrongful purpose, and if such purpose were alleged and proved, the writ would be denied." So too, the supreme court of New Jersey in *Beiver v. United States Wood Preserving Co. et al.*, *supra*, says, "A corporation will not be compelled by mandamus to submit to an examination of its books of account, papers and documents where the applicant therefor shows by his own testimony a lack of good faith and want of frankness, and the corporation evinces a willingness to give him such information as is proper to accomplish his avowed purpose." However, the burden is on the officer refusing the request of inspection, or the corporation, to establish it, as it will not be presumed. On the contrary the reason and motive will be presumed to be for legitimate, lawful and proper purposes.²³

Even where the law requires a shareholder to state the purpose of the examination, such requirement will be deemed to be waived where the corporation declines on other grounds.²⁴ Mr. Dill in his work on corporations,²⁵ suggests that the right to examine and inspect the corporate books and records may be limited by in-

²³ *State v. Pac. Brew. Co.*, 21 Wash. 451, 58 Pac. 584, 47 L. R. A. 208; *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Foster v. White*, 86 Ala. 467, 6 South. 88.

²⁴ *State v. St. Louis Transit Co.*, 124 Mo. App. 111, 100 S. W. 1126.

²⁵ Dill on Corporations, §§ 33 and 34.

serting in the articles of incorporation a clause or condition limiting the examination to stockholders or creditors desiring to do so for legitimate and proper purposes and making the judgment of the officer or agent in charge of such books or records conclusive and binding upon all shareholders and persons having such right.

That certain limitations may be made in the articles of incorporation or by-laws is conceded. However, the law is settled that such limitation or regulation must, in all cases and under all circumstances be reasonable and apply alike to all stockholders or creditors of the corporation.²⁶ It would seem needless to suggest that such attempted restrictions are subordinate and must conform to the governing statute.²⁷ It is elementary that the articles of incorporation and the by-laws of the corporation must conform to the provisions of the statute of the state under which the corporation is organized, and the inclusion of any provision contrary to such law will be absolutely void.

It even has been held that where the by-laws of the corporation require that the transfer or stock books shall be closed for a certain period of time before the annual meeting for the election of the directors and officers, that such provision does not close the books against inspection by the stockholders.²⁸ Generally speaking the stockholder is entitled to make his demand and examination or inspection at the principal place of business of the corporation within the state under whose laws the corporation is created.²⁹

²⁶ 10 Cyc. 356-7.

²⁷ *State v. Citizens' Bank*, 51 La. Ann. 426, 25 South. 318.

²⁸ *State v. St. Louis, etc. R. Co.*, 29 Mo. App. 301.

²⁹ *State v. Park & Nelson Co.*, 58 Minn. 330, 59 N. W. 1048, 49 Am. St. Rep. 516; *Simmons v. Norfolk & Baltimore, etc. Co.*, 113 N. C. 147, 18 S. E. 117, 22 L. R. A. 677, 37 Am. St. Rep. 614; *McConnell v. Comb Min., etc. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703.

It has been held that the right to inspect and examine the corporate books and records is personal to the stockholders of the corporation, and that right does not extend to a custodian of the corporate stock.³⁰ However this rule does not prevent a stockholder from employing an expert accountant or stenographer to assist him in a proper examination of the books and records.³¹

While the examination and inspection of the books and records of the corporation cannot be carried to an unreasonable extent by the stockholder nor can he appropriate the books and records of the corporation to such an extent that it will be detrimental to the interests of the corporation, yet the law is settled that he is entitled at all reasonable times and for proper purposes to inspect the original record, stock and transfer books, or the record of the financial condition of the company.³²

He may examine and inspect contracts or other documents of the corporation.³³ He may also inspect the vouchers and accounts of the corporation.³⁴ A stockholder not only has a right under the statute to inspect the books, records, contracts, papers, and documents of the corporation, but also has a right, at all reasonable times and for proper purposes, to make abstracts and

³⁰ *In re Hastings*, 105 N. Y. 834.

³¹ *State v. St. Louis Transit Co.*, 124 Mo. App. 111, 110 S. W. 1126; *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Foster v. White*, 86 Ala. 467, 6 South. 88; *State v. Citizens' Bank*, 51 La. Ann. 426, 25 South. 318; *Mitchell v. Rubber Co.*, 24 Atl. 407; *Cincinnati Volksblatt v. Hoffmeister*, 62 Ohio St. 189, 78 Am. St. Rep. 707, 48 L. R. A. 732, 56 N. E. 1033; *Elsworth v. Dorwart*, 95 Iowa, 108, 58 Am. St. Rep. 427, 63 N. W. 588; *People v. Nassau Ferry Co.*, 86 Hun. 128, 33 N. Y. S. 244.

³² *Elsworth v. Dorwart*, 95 Iowa, 108, 63 N. W. 588, 58 Am. St. Rep. 427; *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *State v. Pac. Brew. Co.*, 21 Wash. 451, 58 Pac. 584, 47 L. R. A. 208.

³³ *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240.

³⁴ *Elsworth v. Dolwart*, 95 Iowa, 108, 63 N. W. 588, 58 Am. St. Rep. 427.

memoranda of all such books, records, papers and documents of such corporation.³⁵

Where a stockholder is denied and refused the right to make the examination of the books, records and papers of a corporation, he may sue the officers of the corporation for his damages.³⁶ The law is now well settled that a stockholder is entitled to a writ of mandamus whether under the common law or under the statute to enforce his right to inspect and examine the books and records of the corporation.³⁷

It has been held in the supreme court of Ohio that mandamus cannot be maintained to compel the officers of a corporation to permit a stockholder to inspect and examine the books and records of the corporation.³⁸ It is believed, however, that this decision is predicated upon the peculiar wording of the Ohio statute and is not in harmony with the general rule of law upon this subject. The supreme court of New Jersey has held that: Mandamus is the sole remedy of a stockholder wrongfully refused inspection of the books or papers of a corporation.³⁹

“As a general rule, a prior demand for the perfor-

³⁵ *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Cincinnati Volksblatt v. Hoffmeister*, 62 Ohio St. 189, 78 Am. St. Rep. 707, 48 L. R. A. 732, 56 N. E. 1033; *Swift v. Richardson*, 7 Houst. 338, 40 Am. St. Rep. 127, 32 Atl. 143.

³⁶ *Bourdette v. Steward*, 52 La. Ann. 1333, 27 South. 724.

³⁷ *Hub., etc. Const. Co. v. N. E., etc. Co.*, 74 N. H. 282, 67 Atl. 574; *Johnson v. Langdon*, 135 Cal. 624, 67 Pac. 1050, 87 Am. St. Rep. 156; *Stone v. Kellogg*, 165 Ill. 192, 46 N. E. 222, 56 Am. St. Rep. 240; *Fuller v. Hollander & Co.*, 61 N. J. Eq. 648, 47 Atl. 646, 88 Am. St. Rep. 456; *Varney v. Baker*, 194 Mass. 239, 80 N. E. 524; *Wyoming Coal Min. Co. v. State*, 15 Wyo. 97, 87 Pac. 337, 987; *State v. N. A. R. Co.*, 106 La. 621, 31 South. 172, 87 Am. St. Rep. 309; *Elsworth v. Dorwart*, 95 Iowa, 108, 63 N. W. 588, 58 Am. St. Rep. 427; *State v. Jessup, etc. Co. (Del.)*, 77 Atl. 16.

³⁸ *Cincinnati Volksblatt v. Hoffmeister*, 62 Ohio St. 189, 48 L. R. A. 732, 56 N. E. 1033, 78 Am. St. Rep. 707.

³⁹ *Fuller v. Hollander & Co.*, 61 N. J. E. 648, 47 Atl. 646, 88 Am. St. Rep. 456.

mance of the act sought to be compelled and a refusal upon the part of the respondent are necessary to the maintenance of an application for a writ of mandamus."⁴⁰ Under this rule it is necessary for the stockholder to make his application to inspect the books, records and documents of the corporation and be refused such right, otherwise a court of equity will not entertain the application for a writ of mandamus.⁴¹ This demand, however, may be made by an attorney or agent of the stockholder.

The statutes of many of the states now provide that the refusal of the officer or agent of a corporation who has in his custody or control any book, paper or document belonging to the corporation, and who refuses to give to the stockholder lawfully demanding, during business hours, to inspect or take a copy of same, a reasonable opportunity so to do, is guilty of a misdemeanor.⁴²

Where a corporation, acting by a resolution of the board of directors, refuses to permit a stockholder to inspect or examine the books, records and documents, then it would seem that the corporation would be liable in damages to such stockholder, or the corporation itself could be required to permit such examination. Of course the person making the application or suing out a writ of mandamus, must at the time the application is made and at the time the writ of mandamus issues, be a stockholder in the corporation, otherwise the action cannot be maintained.

§ 70. Right to know condition of the corporation.— In addition to the right to examine and inspect the books, records and documents and papers of the corporation, a stockholder has a right to be advised as to

⁴⁰ 19 Am. & Eng. Enc. of Law, 2nd Ed. 759.

⁴¹ *Mitchell v. Rubber Co.* (N. J. E.), 24 Atl. 407.

⁴² Mont. Penal Code, § 989; Rem. & Ball. § 3702; Colo. G. S. 1877, p. 1478, § 203; G. S. 1883, § 249; Nev. G. C. L. § 72; Cal. Penal Code, § 565.

the condition of the business affairs of the corporation. That is, he is entitled to know its financial condition, the condition of its properties, and the conditions of its business affairs generally.⁴³

Indeed, in the state of California, mining corporations are required to furnish to their stockholders at certain periodical times, a report of the condition of the business affairs of the corporation.⁴⁴

§ 71. **Right to alienate and transfer stock.**—The law is well settled that shares of stock are personal property and the owner thereof has an absolute right to freely sell and otherwise dispose of them.⁴⁵ This right of course under certain circumstances may be limited in a way by the statute, the charter, or by-laws of the corporation enacted prior to the time the owner of such stock acquired the same. The courts look with more or less disfavor on statutory, charter, or by-law provisions that attempt to restrict or prohibit the right to freely sell and transfer corporate stock.

In other words the right of alienation is an incident to the shares of stock, and it necessarily follows in consequence of this fact that restrictions upon the right to sell or otherwise dispose of such stock must be found in express legislative enactments, in the articles of incorporation, or in the by-laws duly and regularly made

⁴³ *Weir v. Bay State, etc. Co.*, 91 Fed. 940.

⁴⁴ See Act of Mch, 24, 1905; see also *Miles v. Woodward*, 115 Cal. 308, 46 Pac. 1076.

⁴⁵ *Sean v. Union Premium, etc. Co.*, 115 Mo. App. 685, 92 S. W. 507; *Victor G. Bloede Co. v. Bloede*, 84 Md. 129, 34 Atl. 1127, 33 L. R. A. 107, 57 Am. St. Rep. 373; *Bank of Atchison Co. v. Durfee*, 118 Mo. 431, 24 S. W. 133, 40 Am. St. Rep. 396; *Trisconi v. Winship*, 43 La. Ann. 45, 9 South. 29, 26 Am. St. Rep. 175; *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 38 Am. Rep. 330; *Mundt v. Com. Natl. Bank of Odgen*, 35 Utah, 90, 99 Pac. 454, 136 Am. St. Rep. 1023; *Wells v. Black*, 117 Cal. 157, 48 Pac. 1090, 59 Am. St. Rep. 162, 37 L. R. A. 619; *State v. Curtis*, 9 Nev. 325; *Fitzpatrick v. O'Neill (Mont.)*, 118 Pac. 273.

and adopted prior to the time the holder of such stock became the owner thereof, or the consent of such owner having been secured for good and sufficient consideration.

Even express agreements by shareholders of the corporation between themselves not to sell or otherwise dispose of their stock for a certain period of time, or until the happening of some contingency have been held to be contrary to public policy and void, unless there is some other consideration than mutual promise. This is so by reason of the fact that the courts have always discouraged pools, options or combinations to control corporate stock.⁴⁶ Where, however, the agreement is based upon good and sufficient consideration, it will be binding upon the owners of the stock.⁴⁷

Incident to the right to sell and dispose of corporate stock is the right to have the same transferred on the books of the corporation. The certificates of stock usually contain the provision that it is transferable only on the books of the corporation. While the corporation may pass reasonable rules and regulations pertaining to the transfer of corporate stock,⁴⁸ such provisions always will be subject to the rights of third persons and must under all circumstances be lawful, reasonable, and not retroactive.

Thus the corporation cannot by its by-laws compel a stockholder desiring to sell his stock, to give a written notice to other stockholders, giving such other stockholders the opportunity to purchase at the price named, as such a provision would be a restraint on alienation.⁴⁹

⁴⁶ *Williams v. Montgomery*, 68 Hun (N. Y.), 416, 22 N. Y. S. 1033; but see *Williams v. Montgomery*, 148 N. Y. 519, 43 N. E. 57.

⁴⁷ *N. E. Trust Co. v. Abbott*, 162 Mass. 148, 38 N. E. 432, 27 L. R. A. 271; *Stafford v. Produce, etc. Bank Co.*, 61 Ohio St. 160, 55 N. E. 162, 76 Am. St. Rep. 371.

⁴⁸ *Miller v. Farmers' Mill. & Elev. Co. (Neb.)*, 110 N. W. 995.

⁴⁹ *Victor G. Bloede v. Bloede*, 84 Md. 129, 34 Atl. 1127, 33 L. R. A. 107, 57 Am. St. Rep. 373.

Again where the by-law provision was held to be an unlawful interference with the exercise of the right to alienate and transfer stock, it was held to be void as being in restraint of trade.⁵⁰ So that where the by-laws provide that the shares might be forfeited for nonpayment of subscriptions, it was held to be void.⁵¹ Where a corporation refuses to transfer stock properly presented for transfer, the person representing the same being ready and willing to comply with reasonable by-law regulations, the corporation is liable to the transferee, or shareholder, for the value of such shares on the familiar rule that a refusal to transfer such stock constitutes a conversion of the shares.⁵²

Of course, the refusal must be wrongful. It is immaterial, however, what may be the motives of the transferee in demanding the transfer of the stock. If he is the holder of a valid certificate, duly and regularly issued by the corporation, and upon which the corporation has no lien, he is entitled to have the same transferred on the books of the corporation.

It would seem that in the early decisions in the Supreme Court of California it was held that mandamus would lie. These early decisions, however, have been overruled by that court. Illinois and Louisiana indicate that mandamus is the proper remedy to compel the corporation to transfer shares of stock.⁵³

⁵⁰ *Farmers', etc. Bank v. Wasson*, 48 Iowa, 336, 30 Am. Rep. 398; *Moore v. Bank of Commerce*, 52 Mo. 377.

⁵¹ *Budd v. Multnomah St. R. Co.*, 15 Ore. 413, 3 Am. St. Rep. 169, 15 Pac. 659.

⁵² *Dooley v. Gladiator Con. Coal Co. (Iowa)*, 109 N. W. 864; *Craig v. Hesperia Land & Water Co.*, 113 Cal. 7, 45 Pac. 10, 35 L. R. A. 306, 54 Am. St. Rep. 316; *Ralston v. Bank of California*, 112 Cal. 208, 44 Pac. 476; *Nicolett Natl. Bank v. City Bank*, 38 Minn. 85, 35 N. W. 577, 8 Am. St. Rep. 643; 26 Am. & Eng. Enc. Law (2nd Ed.), 887; *Clark & Marshall on Corporations*, § 603.

⁵³ *Smith v. Automatic Phonograph Co.*, 118 Ill. App. 649; *State v. Consumers', etc. Co.*, 115 La. 782, 40 South. 45. "Mandamus is an appropriate remedy, both at common law * * * to compel the

However, the weight of authority holds that mandamus will not lie to compel the transfer of shares in any corporation, as the party injured has an adequate remedy at law in such event for conversion.⁵⁴

The better plan is a suit in equity to compel the corporation to enter the assignment upon its books, and to issue a new certificate therefor.⁵⁵

The supreme court of New York by Miller, J., commenting upon this remedy presents a very sensible view in this language: "The right of the plaintiff to maintain this action depends upon the question whether an equitable action will lie to compel a transfer of stock by a corporation to the owner of the same, or the plaintiff must seek a remedy by an action at law for damages. The latter action is frequently of no avail, and does not always afford complete and full redress. It is easy to see that a party may have become the owner or purchaser of stock in a corporation, which he desires to hold as a permanent investment, which may be at the time of but little value, in fact without any market value whatever, and its real worth may consist in the prospective rise which the owner has reason to anticipate will follow from facts within his knowledge. To

president and secretary of a private corporation to issue certificates of stock in such corporation, and deliver them to plaintiff, and to transfer the same to plaintiff's name on the books of the corporation where he has become the legal owner of the stock by a purchase of the same at a sale on execution issued on a judgment against the former owner." *Hare v. Burnell*, 106 Fed. (C. C. A.) 280.

⁵⁴ High on Extraordinary Legal Remedies (3rd Ed.), page 286; Morawetz on Private Corporation, § 215; *State v. Jumbo Ex. Min. Co.*, 30 Nev. 192 94 Pac. 74, 133 Am. St. Rep. 715; *Kimball v. Union Water Wks.*, 44 Cal. 173, 13 Am. Rep. 157; *Slemmons v. Thompson*, 23 Ore. 215, 31 Pac. 514; *Tobey v. Hakes*, 54 Conn. 274, 7 Atl. 551, 1 Am. St. Rep. 114.

⁵⁵ *State v. Jumbo Ex. Min. Co.*, *supra*; *Everitt v. Farmers'*, etc. Bank, 82 Neb. 191, 117 N. W. 401, 20 L. R. A. (N. S.) 996; *Western Union Tel. Co. v. Davenport*, 94 U. S. 369, 24 Law. Ed. 1047; *Fitzpatrick v. O'Neill et al.*, 118 Pac. 273.

say that the holder shall not be entitled to the stock, because the corporation, without any just reason, refuses to transfer it, and that he shall be left to pursue the remedy of an action for damages, in which he can recover only a nominal amount, would establish a rule which must work great injustice in many cases, and confer a power on corporate bodies which has no sanction in the law. A court of equity will enforce a specific performance of a contract for the sale of real estate, and compel the execution of a deed by the vendor to the vendee, although an action at law may be brought to recover damages for the breach of the contract. Such a case bears a striking analogy to the one now presented, and the same principle is manifestly applicable where the remedy at law is inadequate to furnish the proper relief." ⁵⁶

§ 72. **Right to sue and defend on behalf of the corporation.**—The law is well settled that a stockholder in a corporation cannot in his individual capacity institute and conduct suits for wrongs committed against the corporation, even though such wrongful act or acts adversely affect the value of his shares.⁵⁷ Thus it has been held that a stockholder cannot sue third parties for breach of contract between them and the corporation; nor for fraud resulting in injury to the corporation; nor for depreciation in the value of stock.⁵⁸ A stockholder cannot maintain a suit against a third party for alleged falsification, mutilation and destruction of

⁵⁶ *Cushman v. Thayer Mfg. Jewelry Co.*, 76 N. Y. 365, 32 Am. Rep. 315.

⁵⁷ *Ninneman v. Fox*, 43 Wash. 43, 86 Pac. 213; *Clark v. Apex Gold Min. Co.*, 13 N. M. 416, 85 Pac. 968; *Wells v. Dane*, 101 Me. 67, 63 Atl. 324; *McClosky v. Snowden*, 212 Pa. 249, 61 Atl. 796; *Johns v. McLester*, 137 Ala. 283, 34 South. 174, 97 Am. St. Rep. 27; 26 Am. & Eng. Enc. of Law (2nd Ed.) 970; 10 Cyc. 963-975; *Morawetz, Private Corporations*, 236-A; *Pomeroy's Equity Jurisprudence*, § 1095.

⁵⁸ *Ninneman v. Fox*, 43 Wash. 43, 86 Pac. 213.

the corporate books and records.⁵⁹ Nor for slandering the title of the property of the corporation.⁶⁰ Nor for making false entries in the books and records of the corporation, thereby causing a depreciation of the plaintiff's stock.⁶¹ The courts universally hold that such wrongs being primarily against the corporation, which is a separate and distinct entity from the stockholder redress must be had in the name of the corporation.⁶² It is to be noted in what has already been said that there is no reference to suits brought by a stockholder where the proper officers of the corporation refuse to act for the protection of the corporate rights. When the proper officers of the corporation, after due and proper demand refuse to bring a suit or action in conformity to the wishes of a stockholder to redress grievances complained of, such stockholder is permitted to institute and conduct litigation for the protection of the corporate property. This rule of law is well settled.⁶³ In the often cited case of *Hawes v. Oakland*, the supreme court of the United States has had occasion to say: "It is equally important that before the share-

⁵⁹ *Wells v. Dane*, 101 Me. 67, 63 Atl. 324.

⁶⁰ *Langdon v. Hillside Coal Co.*, 41 Fed. 609.

⁶¹ *Conway v. Halsey*, 44 N. J. L. 462.

⁶² *Wells v. Dane*, 101 Me. 67, 63 Atl. 324; *Allen v. Curtis*, 26 Conn. 456; *Conway v. Halsey*, 44 N. J. L. 462; *Johns v. McLester*, 137 Ala. 283, 34 South. 174, 97 Am. St. Rep. 27; 26 Am. & Eng. Enc. of Law (2nd Ed.) 970; *Randall v. Dudley*, 111 Mich. 437, 69 N. W. 729; *Langdon v. Hillside Coal, etc. Co.*, 41 Fed. 609.

⁶³ *Boldenweck v. Bullis*, 40 Colo. 253, 90 Pac. 634; *Sivin v. Match Co.*, 66 Atl. 921; *Hingston v. Montgomery*, 121 Mo. App. 451, 97 S. W. 202; *Clark v. Apex Gold Min. Co.*, 13 N. M. 416, 85 Pac. 968; *McCloskey v. Snowden*, 212 Pa. 249, 61 Atl. 796; *Johns v. McLester*, 137 Ala. 283, 34 South. 174, 97 Am. St. Rep. 27; *Crow v. Florence Ice & Coal Co.*, 143 Ala. 541, 39 South. 401; *Macon, etc. Co. v. Shaller*, 141 Fed. 585; *Groel v. United Elec. Co.*, 70 N. J. El. 616, 61 Atl. 1061; *Hawes v. Oakland*, 104 U. S. 450, 26 Law. Ed. 827; *Metcalf v. Am., etc. Furniture Co.*, 122 Fed. 115; *Home Min. Co. v. McKibben*, 60 Kan. 387, 56 Pac. 756; *Moore v. Silver Valley Min. Co.*, 104 N. C. 534, 10 S. E. 679.

holder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain, within the corporation itself, the redress of his grievances or action in conformity to his wishes. He must make an earnest, not a simulated effort with the managing body of the corporation to induce remedial action on their part, and this must be made apparent to the court. If time permits, or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it. The efforts to induce such action as complainant desires on the part of the directors, and of the shareholders when that is necessary, and the cause of failure in these efforts, should be stated with particularity."

Mr. Pomeroy in his very able work on Equity Jurisprudence,⁶⁴ commenting upon this question says: "Whenever a cause of action exists primarily in behalf of the corporation against directors, officers, and others for wrongful dealing with corporate property, or wrongful exercise of corporate franchises, so that the remedy should regularly be obtained through a suit by and in the name of the corporation, and the corporation either actually or virtually refuses to institute or prosecute such a suit, then, in order to prevent a failure of justice, an action may be brought and maintained by a stockholder or stockholders, either individually or suing on behalf of themselves and all others similarly situated, against the wrong-doing directors, officers, and other persons; but it is absolutely indispensable that the corporation itself should be joined as a party,—

⁶⁴ Pomeroy's Equity Jurisprudence (3rd Ed.), § 1095.

usually as a co-defendant. The rationale of this rule should not be misapprehended. The stockholder does not bring such a suit because his rights have been directly violated, or because the cause of action is his, or because he is entitled to the relief sought; he is permitted to sue in this manner simply in order to set in motion the judicial machinery of the court. The stockholder, either individually or as the representative of the class, may commence the suit, and may prosecute it to judgment; but in every other respect the action is the ordinary one brought by the corporation, it is maintained directly for the benefit of the corporation, and the final relief when obtained, belongs to the corporation, and not to the stockholder-plaintiff."

The complaining stockholder will often be confronted with the question where to make the necessary demand upon the proper managing body of the corporation. Also upon whom this demand should be made and the nature and the extent of the demand. The demand it is believed should be made at the principal place of business of the corporation and upon the board of directors. It would seem that it is not sufficient to make this demand upon the individual members of the board, but that it should be made upon the board at some lawful meeting. It would seem to follow therefore that if the corporation has ceased to maintain an office at which demand may be made and that the directors or officers have absconded or abandoned the enterprise, or where there is no directory or governing body to which an application for redress could be made, no demand is necessary before instituting an action.⁶⁵

As suggested by the supreme court of the United States a stockholder must make an earnest not simulated effort with the managing body of the corporation

⁶⁵ *Sheridan Brick Wks. v. Marion Trust Co.*, 157 Ind. 292, 61 N. E. 666, 87 Am. St. Rep. 207; *Tennessee Min. Co. v. Ayers* (Tenn.), 43 S. W. 744; *Wilcox v. Bickle*, 11 Neb. 154, 8 N. W. 436.

to induce remedial action and should be explicit in making his grievances known. The demand of course must be alleged and proved.⁶⁶ That is, the facts as existing must be alleged in a clear and concise manner in the petition or complaint.⁶⁷

The law is now well settled beyond debate or question that where a demand to institute and conduct litigation to protect the corporate interests would be a useless act, or where the managing body of the corporation is in collusion with the wrong doers, or where the interests of the officers or directors would be adversely affected by such suit, or in some cases where two corporations have a common board of directors, no demand need be made, but the stockholder by setting up the facts necessary to constitute such wrong doing may bring such suit.⁶⁸

Mr. Pomeroy in his very able work on Equity Jurisprudence says: "This condition of fact, however, is not indispensable; the action may be maintainable without showing any notice, request, or demand to the managing body or any actual refusal by them to prosecute; in other words, the refusal may be virtual. If the facts as alleged show that the defendants charged with the wrong-doing, or some of them, constitute a majority of the directors or managing body at the time of commenc-

⁶⁶ *Law v. Fuller*, 217 Pa. St. 439, 66 Atl. 754.

⁶⁷ *Vogeler v. Punch*, 205 Mo. 558, 103 S. W. 1001.

⁶⁸ *McConnell v. Combination Min. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703; *Macon v. Shaller*, 141 Fed. 111; *Law v. Fuller*, 217 Pa. 439, 66 Atl. 754; *O'Connor v. Virginia*, 184 N. Y. 46, 76 N. E. 1082; *Brewer v. Boston Theater*, 104 Mass. 378; *Appleton v. Am. Malt Co.*, 65 N. J. Eq. 375, 54 Atl. 454; *Forrester v. Boston & Mont., etc. Min. Co.*, 21 Mont. 544, 55 Pac. 229; *Gerry v. Bismark Bank*, 19 Mont. 191, 47 Pac. 810; *Miner v. Belle Ice Co.*, 93 Mich. 97, 53 N. W. 218, 17 L. R. A. 412; *Boaz v. Sterlingworth, etc. Co.*, 73 N. Y. S. 1039, 68 N. Y. App. Div. 1; *Decatur Mineral Land Co. v. Palm*, 113 Ala. 531, 21 South. 315, 59 Am. St. Rep. 140; *Pomeroy on Equity Jurisprudence* (3rd Ed.), § 1095; 26 Am. & Eng. Enc. of Law (2nd Ed.), 973; 2 Clark & Marshall, § 543.

ing the suit, or that the directors or a majority thereof are still under the control of the wrong-doing defendants, so that a refusal of the managing body, if requested to bring a suit in the name of the corporation, may be inferred with reasonable certainty, then an action by a stockholder may be maintained without alleging or proving any notice, request, demand, or express refusal."

The complaining stockholder instituting a proceeding which should properly be brought by the corporation must in all cases bring such proceeding in the utmost good faith, otherwise the relief sought will not under any circumstances be granted.⁶⁹ Of course a stockholder can maintain only such actions as the corporation itself might institute and maintain, and any defences that would prevail against the corporation itself would to a like extent prevail against the stockholders.⁷⁰ If the action is barred by the statute of limitations, then the stockholders cannot maintain such action. The courts look with more or less disfavor on an action of this nature that is brought by an insignificant number of stockholders. Not but that courts of equity are very careful to see to it that the rights of the minority are fully protected in law, yet the fact that a very few of the stockholders join in the request for the proposed litigation is at least evidence to the mind of the court that it is not meritorious.⁷¹

Judge Sawyer in his opinion in the latter case says: "It is always a suspicious circumstance where a single stockholder, among a large number of a corporation, rushes into a court of equity to vindicate, unaided and

⁶⁹ Beshoar v. Chappell, 6 Colo. App. 323, 40 Pac. 244; Tevis v. Hammersmith, 31 Ind. App. 66 N. E. 79.

⁷⁰ Kessler v. Ensley Land Co., 148 Fed. 1019; Waymire v. Sanf. Co., 112 Cal. 646, 44 Pac. 1086.

⁷¹ Pitcher v. Lone Pine Surprise, etc. Min. Co., 39 Wash. 608, 81 Pac. 1047; Dannmeyer v. Coleman, 11 Fed. 97, 8 Sawy. 51.

alone, the rights of the corporation and all other stockholders; and especially is this so, where the amount of stock owned by him is so very limited that in case of success his own share of the recovery will be so small as to make the maxim '*De minimis non curat lex*' very properly applicable."

Where the stockholder participates in the wrongful act or where after he has been fully advised of such act, he neglects to bring suit within a reasonable time thereafter, or where he acquiesces in such wrongful conduct on the part of the managing officers, he will be barred from maintaining an action in his own name. Again where an action is brought, the party against whom the suit is being maintained is entitled to be placed *in statu quo*, that is, he is entitled to any of the returns that might have been delivered to the corporation. So too, laches is a good defense in the action of stockholders brought on behalf of the corporation.⁷² By reason of the fact that a purchaser of stock in a corporation is not allowed to attack the acts and management of the company prior to the acquisition of his stock, it is necessary that the stockholder be such at the time that the alleged wrongs were committed. In other words, a majority of courts hold that a person who did not own stock at the time of the transaction complained of cannot complain or bring a suit to have it declared illegal.⁷³

⁷² *Alexander v. Searcy*, 81 Ga. 536, 8 S. E. 630, 12 Am. St. Rep. 337; *Edwards v. Mercantile Trust Co.*, 124 Fed. 381; *Forrester v. Boston, etc. Min. Co.*, 21 Mont. 544, 55 Pac. 353.

⁷³ *Hawes v. Oakland*, 104 U. S. 450, 26 Law. Ed. 827; *Dimpfell v. Ohio, etc. R. Co.*, 110 U. S. 209, 3 Sup. Ct. Rep. 573, 28 Law. Ed. 121; *Taylor v. Holmes*, 127 U. S. 489, 8 Sup. Ct. Rep. 1192, 32 Law. Ed. 179; *S. W. Nat. Gas Co. v. Fayette Fuel Gas Co.*, 145 Pa. St. 13, 23 Atl. 224; *Alexander v. Searcy*, 81 Ga. 536, 12 Am. St. Rep. 337, 8 S. E. 630; *Clark v. American Coal Co.*, 86 Iowa, 436, 53 N. W. 291, 17 L. R. A. 557; *United Elec. Securities Co. v. Louisiana Elec. Light Co.*, 68 Fed. 673; *Venner v. Atchinson, etc. R. Co.*, 28 Fed. 581; *Heath v. Erie R. Co.*, 8 Blatchf. 347; *Dannmyer v. Coleman*, 8 Sawy. 51, 11 Fed. 97; 4 Thompson on Corporations, § 4569; *Home Fire Ins.*

A stockholder has absolutely no right to interfere or appear and defend on behalf of the corporation in suits brought against the corporation. This is so even though it might appear that the corporation as such is in collusion and sympathy with the plaintiffs and that the corporation will be deprived of a fair and just defense of its rights. However, stockholders are not barred from protecting their rights, for the law permits him in case the corporation refuses to defend or in case the managing powers of the corporation are in collusion with the plaintiffs, to either file a bill in equity in the nature of a cross bill or intervene in the suit and set up the facts, in which event courts of equity will be prompt to protect the rights of the corporation through the intervention of the stockholder.⁷⁴ And where a judgment was obtained against a corporation having ceased to do business it is not binding upon a stockholder who had no notice of the suit and against whom the judgment is sought to be enforced, the summons having been served upon a trustee after his connection with the corporation had ended. Under such circumstances, the stockholder is entitled to a vacation of the judgment against the corporation, and defend against the merits.⁷⁵

While it is not entirely a question of law, we cannot close this question without suggesting that while courts will always protect stockholders, especially minority stockholders, in their rights, however, notwithstanding the legal and equitable rights that belong to each stockholder of a corporation, it should not be forgotten that

Co. v. Barber, 67 Neb. 644, 93 N. W. 1024, 108 Am. St. Rep. 716; Rankin v. S. W. Brewery Co., 12 N. M. 54, 73 Pac. 614; Johns v. McLester, 137 Ala. 283, 34 South. 174, 97 Am. St. Rep. 27-52; Contra Bollitz v. Gould, 202 N. Y. 11, 94 N. E. 1088.

⁷⁴ Bronson v. La Crosse & Milwaukee, etc. R. Co., 2 Wall. (U. S.), 283, 17 Law. Ed. 725.

⁷⁵ Stanton v. Gilpin, 38 Wash. 191, 80 Pac. 290.

a stockholder should consider well and long before plunging it into litigation. That is, we undertake to suggest to the stockholders that even though their rights may seem in a measure to have been violated, it will often be advisable to use some caution and patience, and undertake to adjust the differences outside of court before involving the corporation in litigation. It should always be remembered that often honest and capable men will differ materially as to the method and plan of promoting a corporation. Operations and measures viewed from different standpoints are susceptible of different views. The surest and most certain way to wreck and ruin a corporation, especially one yet in the promotion period is to involve it in litigation, and the surest and most certain way to deprive each stockholder of his interest in that corporation is by constant and continuous bringing of law suits.

Our conclusion, therefore, is that every possible means should be resorted to before appealing to the courts. Of course we do not mean to say that the stockholders should sit idly by, until their rights have been wrongfully taken from them by a board of directors who have no regard for honesty and fair dealing, but this is seldom the case.

§ 73. **Right to appointment of receiver.**—The statutes of the several states must be consulted to determine what acts on the part of the managing powers of the corporation will entitle the stockholders to an appointment of a receiver. It has been held that a receiver will not be appointed, either at the instance of a stockholder, or creditor, unless there is some evidence of fraud, or that the property is being squandered, dissipated, wasted, or not properly cared for by the managing body of the corporation, or that there is danger of the property being lost to the corporation.

This is a general rule of law and abundantly sustained by authorities.⁷⁶

The law is well settled that courts have inherent power to appoint a receiver of a corporation where the property is being mismanaged,¹ and is in danger of being lost on account of fraud and collusion of the officers, and by reason of such fraud the corporation is in imminent danger of becoming insolvent.⁷⁷ There is no question that fraud, or mismanagement of a corporation will authorize a court of equity to appoint a receiver.⁷⁸ It would therefore necessarily follow that where there is imminent danger of loss through mismanagement or fraud, a court of equity will appoint a receiver to take charge of the corporation.⁷⁹

In *Republican Mountain Silver Mines v. Brown*,⁸⁰ the court said: "The jurisdiction that a court of equity may lawfully exercise over the affairs of an ordinary business corporation, in the absence of any statute conferring extraordinary powers, is likewise well defined. A court of chancery may at the instance of a stock-

⁷⁶ *Fernald v. Spokane, etc. Co.*, 31 Wash. 672, 72 Pac. 462; *Worth Mfg. Co. v. Bingham*, 116 Fed. 785; *State v. 2nd. Judicial District*, 15 Mont. 324, 48 Am. St. Rep. 682, 39 Pac. 316; *State v. Ross*, 122 Mo. 435, 25 S. W. 947, 23 L. R. A. 534; *Hallenbourg v. Corby Grand Copper Co.*, 8 Ariz. 329, 74 Pac. 1052; *Murray v. Sup. Ct.* 129 Cal. 628, 62 Pac. 191; *International Trust Co. v. United Coal Co.*, 27 Colo. 246, 83 Am. St. Rep. 59, 60 Pac. 621; *Davies v. Munroe Water Wks. & Light Co.*, 107 La. 145, 31 South. 694; *Vila v. Grand Island Elec. Light, etc. Co.*, 68 Neb. 222, 94 N. W. 136, 97 N. W. 613; *Cameron v. Groveland Imp. Co.*, 20 Wash. 169, 72 Am. St. Rep. 26, 54 Pac. 1128; *State v. Union Natl. Bank*, 145 Ind. 537, 57 Am. St. Rep. 209; *Gibbs v. Morgan*, 9 Idaho, 100, 72 Pac. 733; *State v. Peoples, etc. Bank*, 197 Mo. 574, 94 S. W. 953.

⁷⁷ *Cameron v. Groveland Imp. Co.*, 20 Wash. 169, 54 Pac. 1128, 72 Am. St. Rep. 26; *Gibbs v. Morgan*, 9 Idaho, 100, 72 Pac. 733.

⁷⁸ *State v. People, etc. Bank*, 197 Mo. 574, 94 S. W. 953.

⁷⁹ *State v. Ross*, 122 Mo. 435, 25 S. W. 947, 23 L. R. A. 534; *Dozier v. Logan*, 101 Ga. 173.

⁸⁰ *Republican Mountain Silver Mines v. Brown*, 58 Fed. 644, 7 C. C. A. 412, 24 L. R. A. 776; *Hall v. Nieuirkirk*, 12 Idaho, 33, 85 Pac. 485, 118 Am. St. Rep. 201.

holder, and if the company itself refuses to move, lawfully entertain a bill to depose or to restrain the officers or directors of a corporation, when it appears that in their capacity as agents or trustees of the stockholders they have committed, or are about to commit, acts that are tantamount to a breach of trust, whether such acts consist of fraudulent dealings with the corporate property or funds, or whether they consist in engaging the corporation in enterprises that are beyond the scope of its chartered powers. In more general phrase, it is sometimes said that a court of chancery may grant equitable relief against a corporation, at the suit of an individual, 'whenever a sufficient cause for relief is shown upon ordinary principles of equity jurisprudence.' "

The authorities are absolutely harmonious in holding that a stockholder of a corporation is the proper person to apply for a receiver, and the courts will not hesitate to appoint a receiver at the instance of a stockholder on the facts hereinbefore noted.⁸¹ While courts of equity will protect the minority stockholders to the letter of their reserved rights, yet the fact that an insignificant number of shares applies for an appointment of a receiver is enough to indicate to a court that the suit is not brought in the best of faith. Thus the supreme court of New Jersey in *Stokes v. Knickerbocker Inv. Co.*⁸² has held that a receiver will not be appointed at the suit of the shareholders owning and holding less than one-fourth of the outstanding stock of the corporation even though there are charges of fraud against the managers of the corporation. So too, Texas has held that even and although the corporation was insolvent, a receiver would not be appointed on the ap-

⁸¹ *Wain P. Co. v. Hammons*, 129 Ind. 368, 27 N. E. 487; *Hall v. Nieukirk*, 12 Idaho, 33, 85 Pac. 485, 118 Am. St. Rep. 188; *Culver, etc. Co. v. Culver*, 81 Ark. 102, 99 S. W. 391.

⁸² *Stokes v. Knickerbocker Inv. Co.*, 70 N. J. Eq. 518, 61 Atl. 736.

plication of shareholders owning and holding comparatively small interests in the corporation.⁸³

§ 74. **Rights and powers of minority.**—We shall not enter into a very lengthy or elaborate discussion of the rights and powers of the minority stockholders. As the power to control the business affairs of the corporation is vested in the majority the law is well settled that the acts of the majority cannot be questioned unless such acts be illegal or *ultra vires*.⁸⁴ In other words, in all questions pertaining to the management of the internal affairs of the corporation, the courts will not interfere in such management, so long as their acts are lawful and within the objects and purposes of the charter of the corporation.⁸⁵

That the rule announced by these authorities is founded in good law there can be no question, for if the minority stockholders were permitted to interfere every time they disagreed with the policy of the management of the corporation, then the corporation would be constantly and continuously in litigation, as honest men often differ materially as to the policy to be pursued by the corporation. The courts will not listen to the minority, even though it may be shown that the methods proposed by them would be more successful if adopted by the management of the corporation than the policy and methods used by the majority.⁸⁶

However, the law nevertheless is well settled that the minority stockholders are entitled to require that

⁸³ *Espuella Land & Cattle Co. v. Bindle*, 5 Tex. Civ. App. 18, 23 S. W. 819.

⁸⁴ *Metcalf v. Am. Skl. Fur. Co.*, 122 Fed. 115; *Lowe v. Pioneer Threshing Co.*, 70 Fed. 646; *U. S. Steel Corp. v. Hodge*, 64 N. J. Eq. 818, 54 Atl. 1.

⁸⁵ *Rogers v. Nashville, etc. Co.*, 91 Fed. 299, 36 C. C. A. 517; *Donald v. Am. Smelting Co.*, 61 N. J. Eq. 458, 48 Atl. 786.

⁸⁶ *Donald v. Am. Smelting Co.*, 65 N. J. Eq. 458; *Rogers v. Nashville, etc. Co.*, 91 Fed. 299, 36 C. C. A. 517.

the property of the corporation shall be used for the purpose of carrying out the object for which the corporation was organized and any attempt to divert the property into channels outside the corporate business may be prevented by them. They may also prevent or remedy any willful or gross mismanagement or waste of the corporate property. There is no question that minority stockholders may prevent *ultra vires* acts proposed or contemplated by the majority shareholders.⁸⁷

This rule of law is announced on the broad principle that, the law requires of a majority of the stockholders of a corporation good faith in their control and management of the corporation as regards the minority, and in this respect the majority stand in much the same attitude toward the minority that the directors sustain toward the stockholders.⁸⁸ We have heretofore suggested that minority stockholders may enjoin the corporation from selling and disposing of the entire property and assets of the corporation.⁸⁹

They may enjoin the majority from purchasing property at an exorbitant or unreasonable price, provided however that such price is so unreasonable as to be presumed to be fraudulent.⁹⁰ So too, the minority have a right to prevent reorganization or consolidation of the corporation.⁹¹ In short the minority may at all times demand that the control vested by law in the majority

⁸⁷ *Ryan v. Williams*, 100 Fed. 172; *McLeod v. Lincoln Medical College* (Neb.), 98 N. W. 672; *Forrester v. Boston, etc. Co.*, 21 Mont. 544; *Crichton v. Webb, etc. Co.*, 113 La. 167, 36 South. 926, 104 Am. St. Rep. 500; *Hays v. Pierson*, 65 N. J. Eq. 353, 45 Atl. 1091; *Fletcher v. Alpena Circuit Judge*, 136 Mich. 511; *Garretson v. Pac. Crude Oil Co.*, 146 Cal. 184, 79 Pac. 838.

⁸⁸ *Farmers' L. & T. Co. v. N. Y., etc. Co.*, 150 N. Y. 410, 44 N. E. 1043, 34 L. R. A. 76, 55 Am. St. Rep. 689.

⁸⁹ *McLeod v. Lincoln Medical College*, 98 N. W. 672.

⁹⁰ *Hunt v. Am. Grocery Co.*, 81 Fed. 532; *Forrester v. Boston, etc. Co.*, 21 Mont. 544, 55 Pac. 229; *Price v. Holcomb*, 89 Iowa, 123, 56 N. W. 407.

⁹¹ *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737.

shall neither be abused⁹² nor manipulated in any way to the advantage of such majority or any part thereof.

Generally speaking the minority stockholders have no right to maintain an action in behalf of the corporation for wrongs committed affecting the corporate property, unless they shall first have made demand upon the board of directors to bring such litigation, or allege in their complaint and show by their proof that it would be unavailing by reason of the fraudulent and collusive acts of the directors or stockholders. The minority have no right to appear or defend on behalf of the corporation as such. They may however interplead in a suit or file a cross complaint where the corporate officers wrongfully refuse to properly defend the corporation and its property.

The minority always are entitled to have due and proper notice of any and all meetings of the corporation, which notice shall be given them according to the provisions in the by-laws. So too, they are always entitled to an accounting and to know the financial condition and plans of the corporation and are entitled to dividends from their investment, as earned and declared.

It often has been suggested by some of the text writers that the minority always are bound hand and foot by the majority, and that courts furnish little or no protection against wrongful manipulations of such majority. This statement is far from correct. Courts of equity have always been quick to protect the invaded rights of the minority stockholders and it is believed that there is no question whether it be a fraudulent act, or willful mismanagement that courts of equity do not have proper and adequate remedies for the minority stockholders.

⁹² *Twin Lick Co. v. Marbury*, 91 U. S. 587, 23 Law. Ed. 328; *Forrester v. Boston, etc. Co.*, 21 Mont. 544, 55 Pac. 229; *Wilbur v. Stopel*, 82 Mich. 344, 46 N. W. 724, 21 Am. St. Rep. 568.

We do not mean by this that it is advisable for minority stockholders whenever they feel aggrieved, to rush into court and put the corporation and its property into litigation, but we do mean that in so far as the existing laws are concerned, minority stockholders are fully protected in their rights, notwithstanding this minority will often find it more advisable to settle their differences and grievances outside of courts, than to involve the corporation in litigation, by reason of the fact that litigation, strife and dissension among the stockholders of the corporation must and will lead to inevitable ruin both to the corporation and the corporate property.

§ 75. **Rights of preferred stockholders.**—Preferred stockholders in the absence of charter, by-law, or contract restrictions, are entitled to the same rights and privileges as the holders of common stock. The real purpose of preferred stock is to guarantee to its holders a preference in the distribution of dividends. The certificate of stock issued by the corporation will be the contract between the corporation and the holder thereof. There are many expressions in the reported cases indicating that the holder of preferred stock is a creditor. These expressions in many cases lead to erroneous ideas upon this subject.

“The relation of a holder of preferred stock is, in some of its aspects, similar to that of a creditor, but he is not a creditor save as to dividends after the same are declared. Nor does he sustain a dual relation to the corporation. He is either a stockholder or a creditor. He cannot, by virtue of the same certificate, be both. If the former, he takes a risk in the concerns of the company, not only as to dividends and a proportion of assets on the dissolution of the company, but as to the statutory liability for debts in case the corporation becomes insolvent; if the latter, he takes no interest in the company's affairs, is not concerned in its proper-

ties, or profits as such, but his whole right is to receive agreed compensation for the use of money he furnishes, and the return of the principal when due. Whether he is one or the other depends upon a proper construction of the contract he holds with the company."⁹³

While the law is well settled that the holder of preferred stock is entitled to a preference in the matter of dividends over the holders of common stock, it is equally well settled that the dividends can be paid only from the net earnings of the company. This is true even when an attempt is made to guarantee the dividends. Generally speaking, the time and manner of declaring dividends on preferred stock rests in the sound discretion of the board of directors. The courts are liberal in upholding this discretionary power.⁹⁴ Of course, the least suspicion of fraud, or bad faith on the part of the directors in refusing to declare and pay dividends will readily cause a court of equity to order the dividends declared and paid.⁹⁵

In the absence of any agreement, or statute, or by-law to the contrary, preferred stockholders are entitled to vote.⁹⁶ Indeed, preferred stockholders may, by the charter and by-laws, be vested with the sole voting power of the corporation.⁹⁷ On the other hand the charter or by-laws may legally provide that they shall have no vote. This is the usual practice, where preferred stock is issued.

Upon the dissolution of the corporation the assets and property must be distributed to all of the stockholders alike in proportion to the number of shares held by each and holders of preferred stock are entitled to

⁹³ *Miller v. Ratterman*, 47 Ohio St. 141, 24 N. E. 496.

⁹⁴ *N. Y., etc. Co. v. Nichols*, 119 U. S. 296, 30 Law. Ed. 363.

⁹⁵ *Storrow v. Texas, etc. Co.*, 87 Fed. Rep. 612; *Hazeltine v. Belfast, etc. Co.*, 79 Me. 411, 10 Atl. 328, 1 Am. St. Rep. 330; *McLean v. Pittsburgh Plate Glass Co.*, 59 Pa. St. 112.

⁹⁶ *Lockhart v. Van Alstyne*, 31 Mich. 76, 18 Am. Rep. 156.

⁹⁷ *McIntosh v. Flint, etc. Co.*, 32 Fed. 350.

no greater share of such property, or assets unless their contract with the corporation expressly provides otherwise. It is customary however to provide in the by-laws or articles of incorporation, for the payment to the preferred stockholders of certain amounts before the common stock receives anything.

§ 76. **Remedies.**—As a general rule the remedy of stockholders is in equity and not in law. That is to say, that courts of equity will readily enforce any of the rights of stockholders but the stockholders will not be permitted to maintain actions at law for damages resulting from an infringement of their rights.

§ 77. **Liabilities.**—Practically all of the states now have statutes making the stockholders liable for the debts of the corporation to the extent of the amount that may be unpaid on their stock. That is, where stock has been purchased for less than its par value, the stockholder is liable to the creditors for the difference paid and the par value.

In California each stockholder of a corporation, or joint stock association, shall be individually and personally liable for such proportion of all its debts and liabilities contracted or incurred during the time he was a stockholder, as the amount of stock or shares owned by him bears to the whole of the subscribed capital stock, or shares of the corporation, or association.⁹⁸

⁹⁸ Section 3, article 12, Const. of California as amended 1908; construed in *Thomas v. Wentworth Hotel Co. et al.*, 158 Cal. 275, 110 Pac. 942, 139 Am. St. Rep. 120; *Jones v. Goldtree Bros. Co.*, 142 Cal. 384, 77 Pac. 939; *Peck v. Noee*, 154 Cal. 351, 97 Pac. 865.

CHAPTER IX.

DE FACTO CORPORATIONS.

- § 78. Definitions.
- 79. Prerequisites of a *de facto* corporation.
- 80. Valid law.
- 81. *Bona fide* attempt to organize a corporation.
- 82. Actual exercise of corporate powers.

§ 78. **Definitions.**—A body is regarded as a *de facto* corporation only where there has been an effort to conform to the law in establishing a corporation, and some minor defect exists merely as to the mode of complying with the law, and the body is dealt with and acts as a corporation. "A corporation," says the supreme court of Alabama, "*de facto*, exists when, from irregularity or defect in its organization or constitution, or from some omission to comply with the conditions precedent, a corporation *de jure* is not created, but there has been a colorable compliance with the requirements of some law under which an association might lawfully be incorporated for the purpose and powers assumed, and a user of the rights claimed to be conferred by law," or in other words, when there is an organization with color of law and an exercise of corporate rights and franchises.¹

¹ *Snider Sons Co. v. Troy*, 91 Ala. 224, 8 South. 658, 11 L. R. A. 515, 24 Am. St. Rep. 887; see also *Brown v. Atlanta R. Co.*, 113 Ga. 462, 39 S. E. 71; *Clark v. Am. Cannel Coal Co.*, 165 Ind. 213, 73 N. E. 1083, 112 Am. St. Rep. 217; *Marshall v. Keach*, 227 Ill. 35, 81 N. E. 29, 118 Am. St. Rep. 247; *Hasselman v. U. S. M. Co.*, 97 Ind. 365; *Owensboro Wagon Co. v. Bliss*, 132 Ala. 253, 90 Am. St. Rep. 907, 31 South. 81; *Milwaukee Gold Extraction Co. v. Gordon*, 95 Pac. 995, 37 Mont. 209; *McTighe v. Macon Const. Co.*, 94 Ga. 306, 21 S. E. 701, 32 L. R. A. 208; *Burton v. Schillbach*, 45 Mich. 504, 8 N. W. 497; *Eaton v. Walker*, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Jennings v. Dark (Ind.)*, 92 N. E. 778; *Stevens v. Episcopal Church*

§ 79. **Prerequisites of a de facto corporation.**—Difficulty will often be encountered in ascertaining just what is necessary to constitute a *de facto* corporation. However, it is believed that the rules following in this chapter will serve as a sufficient guide to determine, in nearly all cases, whether or not, the association has sufficiently complied with the incorporation acts, to be entitled to a *de facto* existence.

Under the great weight of authority, three things are necessary to the existence of a corporation *de facto*. First, a valid law, under which a corporation with powers assumed, or to be carried out, can be incorporated; second, a *bona fide* attempt to organize a corporation under such a law; and third, an actual exercise of the corporate powers. In the case of *Clark v. American Cannel Coal Co.*, *supra*, Monks, J., speaking for the supreme court of Indiana says, "It is essential to the existence of a *de facto* corporation, however, that there be first, a valid law under which a corporation, with the powers assumed, might be incorporated; second, a *bona fide* attempt to organize a corporation under such law; third, an actual exercise of corporate powers."

§ 80. **Valid law.**—It thus is seen that the first requisite to the existence of a corporation *de facto* is a valid law, under which such a corporation may be incorporated.² It, therefore, necessarily follows that there

History Co., 125 N. Y. S. 573; *Hossack v. Ottawa Dev. Ass'n*, 224 Ill. 274, 91 N. E. 439; *Perrine v. Levin*, 123 N. Y. S. 1007; *Wiel v. Wiel Bldg., etc. Co. (La.)*, 53 South. 56.

² *Milwaukee Gold Extraction Co v. Gordon*, 37 Mont. 209, 95 Pac. 995; *Norton v. Shelby Co.*, 118 U. S. 425, 30 Law. Ed. 178; *Clark v. Am. Cannel Coal Co.*, 165 Ind. 213, 73 N. E. 1083, 112 Am. St. Rep. 217; *Davis v. Stevens*, 104 Fed. 235; *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 52 Am. St. Rep. 220, 29 L. R. A. 143; *Eaton v. Walker*, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Ga. South., etc. Ry. Co. v. Merc. Trust Co.*, 94 Ga. 306, 47 Am. St. Rep. 153; *Brandenstein v. Hoke*, 101 Cal. 131, 35 Pac. 562; *Am. Trust Co. v. Minn., etc. Co.*, 157 Ill. 641, 42 N. E. 153; *Hossack v. Ottawa, etc. Ass'n*, 244 Ill.

cannot be a corporation *de facto*, under an unconstitutional statute. "A corporation *de facto* cannot exist in any case, where there is no law authorizing a *de jure* corporation; and where there is no grant of power existing for the creation of the corporation pretended to be organized, there can be no *de facto* corporation,"³ nor can a corporation *de facto* exist in violation of a positive statute.⁴

§ 81. **Bona fide attempt to organize a corporation.**—The second requisite, as we already have seen, to the existence of a *de facto* corporation, is at least a substantial or colorable compliance with such laws, authorizing the organization of the corporation. Thus, even if there may be a valid existing law, under which the corporation may be organized, yet there is no corporation unless there is at least a colorable attempt to comply with this law.

It is very difficult to lay down any rule that would govern in all cases. However, as we have suggested, the courts are unanimous in their opinion that there must be at least a colorable compliance with the statute authorizing the incorporation. Some courts go to the extent of holding that there must be a substantial compliance with all the prerequisite conditions of the statute. However, all in all, the courts are now very liberal in matters of this kind, and where the articles of incorporation have not been signed by the number of incorporators required by law, it was held not to be fatal to

274, 91 N. E. 439; *State v. Rutland Light & Power Co.* (Vt.), 81 Atl. 252.

³ *Indiana Bond Co. v. Ogle*, 22 Ind. App. 593, 54 N. E. 407, 72 Am. St. Rep. 326; *Davis v. Stevens*, 104 Fed. 235; *Eaton v. Walker*, 76 Mich. 579, 43 N. W. 638, 6 L. R. A. 102; *Huber v. Martin*, 127 Wis. 412, 105 N. W. 1031, 115 Am. St. Rep. 1023; *Brown v. Atlanta, etc. Co.*, 113 Ga. 462, 39 S. E. 71.

⁴ *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 52 Am. St. Rep. 220, 29 L. R. A. 143; *Duke v. Taylor*, 37 Fla. 64, 19 South. 172, 53 Am. St. Rep. 232, 31 L. R. A. 484.

the existence of a *de facto* corporation.⁵ It also has been held that failure to state the place of residence of the directors, was not fatal to a *de facto* existence,⁶ nor the fact that one of the incorporators signed as an officer of another corporation,⁷ and where the certificate did not comply with the statute.⁸

It has been held that failure to file the articles of incorporation with the secretary of state, or other proper recording officer does not preclude the existence of a corporation *de facto*,⁹ and where the organization complied with all the requirements of the law, except to publish its articles, as the law required, it was held to be a *de facto* corporation.¹⁰

Failure to file the required certificate of the paid up capital of the corporation, as required by law, has been held not to prevent the organization being a *de facto* corporation.¹¹ It has even been held that although the law under which the corporation claims incorporation is unconstitutional, the organization may be a corporation *de facto*.¹² It is to be said, however, that this last proposition is contrary to the great weight of authority. Some courts go to the extent of holding that unless there is a substantial compliance with the prerequisite requirements of the incorporating laws, neither a corporation *de facto* nor *de jure* exists.¹³

⁵ *Rondell v. Fay*, 32 Cal. 354; *Keys v. Smith*, 67 N. J. L. 190, 51 Atl. 122.

⁶ *Snider, etc. Co. v. Troy*, 91 Ala. 224, 24 Am. St. Rep. 887, 8 South. 658, 11 L. R. A. 515.

⁷ *Keene v. Van Reuth*, 48 Md. 184.

⁸ *Franks v. Mann*, 106 Wis. 118, 81 N. W. 1014, 48 L. R. A. 856.

⁹ *Grand River, etc. Co. v. Rollins*, 13 Colo. 4, 21 Pac. 897; *Turnpike Co. v. Babb*, 88 Ky. 226, 10 S. W. 794; *Bakersfield Town Hall Ass'n v. Chester*, 55 Cal. 98; *Tarbell v. Page*, 24 Ill. 46; *Herrod v. Hamer*, 32 Wis. 162; *Lusk v. Riggs*, 70 Neb. 718, 102 N. W. 88.

¹⁰ *Holmes v. Gilliland*, 41 Barb. (N. Y.) 568.

¹¹ *Jones v. Hale*, 32 Ore. 465, 52 Pac. 311.

¹² *Coxe v. State*, 144 N. Y. 396, 39 N. E. 400; *Georgia S. & F. R. Co. v. M. T. & D. Co.*, 94 Ga. 306, 47 Am. St. Rep. 153.

¹³ *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 52 Am. St.

§ 82. **Actual exercise of corporate powers.**—The third and last requisite of a corporation *de facto* is an actual exercise of corporate powers. That is, a user of its franchise and privileges. This user of the corporate rights and franchise is construed in law to mean some act of carrying out the objects and purposes for which the corporation was organized.

"A sufficient user" said the supreme court of Minnesota, "of corporate rights to impart the character of a corporation *de facto* to a body of men who have attempted to organize under the law is shown by the collection of subscriptions to the capital stock of the association, the election of officers, the adoption of by-laws, the purchase of a lot, the erection of a building thereon, and the demise of portions of that building to various tenants."¹⁴

The legality of the organization and existence of a *de facto* corporation that has exercised corporate powers can be questioned only by the State, and cannot be questioned collaterally in a suit between private parties.¹⁵ Many states have statutes defining the status of *de facto* corporations.

Rep. 220, 29 L. R. A. 143; *Bergeron v. Hobbs*, 96 Wis. 641, 71 N. W. 1056, 65 Am. St. Rep. 85; *Abbott v. Omaha Smelting Co.*, 4 Neb. 416; *Ferris v. Thaw*, 72 Mo. 446; *Mokelumne Hill Min. Co. v. Woodbury*, 14 Cal. 265, 73 Am. Dec. 658; *Kaiser v. Lawrence Sav. Bank*, 56 Iowa, 104, 8 N. W. 772, 41 Am. Rep. 85; *Harris v. McGreagor*, 29 Cal. 125.

¹⁴ *Finnegan v. Noerenberg*, 52 Minn. 239, 38 Am. St. Rep. 552, 53 N. W. 1150, 18 L. R. A. 778; see also *Kwapil v. Bell Tower Co.*, 55 Wash. 583, 104 Pac. 824.

¹⁵ *Jones v. Aspen Hdw. Co.*, 21 Colo. 263, 40 Pac. 457, 52 Am. St. Rep. 220, 29 L. R. A. 143; *Marsters v. Umpqua Oil Co.*, 49 Ore. 374, 90 Pac. 151; *Leavengood v. McGee*, 50 Ore. 233, 91 Pac. 453; *People v. Montecito Water Co.*, 97 Cal. 276, 32 Pac. 236; *Humphreys v. Mooney*, 5 Colo. 282; *Marsh v. Mathias*, 19 Utah, 350, 56 Pac. 1074; *Carroll v. Pac. Natl. Bank*, 19 Wash. 639, 54 Pac. 32.

CHAPTER XII.

CORPORATE CONTRACTS.

§ 83. Scope of power to contract.

84. Execution of contracts.

85. Contracts executed on behalf of the corporation prior to its existence.

86. Contracts of an extraordinary nature.

87. Contracts in which directors have a personal interest.

88. Contracts between corporations having a common board of directors.

§ 83. **Scope of power to contract.**—The law is well settled that a corporation created for a specific purpose not only can make no contract forbidden by its charter, but in general can make no contract which is not necessary either directly or incidentally, to enable it to answer that purpose. In deciding, therefore, whether a corporation can make a particular contract, it must be considered, in the first place, whether its charter, or some statute, binding upon it forbids or permits it to make such a contract; in the second place, whether the power to make such a contract may not be implied on the part of the corporation as directly or incidentally necessary to enable it to fulfill the purpose of its existence; or whether the contract is entirely foreign to that purpose; a corporation has no other powers than such as are specifically granted, or such as are necessary for the purpose of carrying into effect the powers expressly granted.¹

¹ *Weckler v. The First National Bank of Hagerstown*, 42 Md. 581, 20 Am. Rep. 95; see also *Deringer's Administrator v. Deringer's Administrator*, 5 Houston (Del.) 416, 1 Am. St. Rep. 150; *Killingsworth v. Portland Trust Co.*, 18 Ore. 351, 23 Pac. 66, 17 Am. St. Rep. 737, 7 L. R. A. 638; *Sutro Tunnel Co. v. Segregated Belcher Min. Co.*, 19 Nev. 121, 7 Pac. 271; *Moss v. Averell*, 10 N. Y. 449; *Lincoln*

visions of the by-laws, which authorization should be spread upon the minutes of the meeting and recorded among the permanent records of the corporation.³ However, this may not always be necessary to make the contract binding upon the corporation.³

Contracts entered into by a corporation need not be in writing, unless contracts of like nature entered into by individuals are required to be in writing,⁴ and while it is customary, it is not absolutely necessary to affix the official seal of the corporation to contracts entered into by it.⁵ However the seal is *prima facie* evidence that the contract was executed by proper authority,⁶ and where no seal is used, the authority of the officer must be proved.⁷

Therefore, it always is advisable to affix the official seal of the corporation to all of the corporate contracts. Officers executing the contract should always be careful that it clearly appears that the contract is made on behalf of the corporation, otherwise it might be construed as a contract binding upon the individual who signed it, rather than binding upon the corporation.

§ 85. **Contracts executed on behalf of the corporation prior to its existence.**—A corporation can have no directors, officers or agents, prior to its existence as a corporation, therefore, no valid contract can be made

³ *Limer v. Traders' Co.*, 44 W. Va. 175, 28 S. E. 730; *Nicholstone, etc. Co. v. Smalley*, 21 Tex. Civ. App. 210, 51 S. W. 527; *Lockwood v. Thunder Bay, etc. Co.*, 42 Mich. 536, 4 N. W. 292; *Morrison v. Wilder Gas Co.*, 91 Me. 492, 40 Atl. 542, 64 Am. St. Rep. 257; *Buttrick v. Nashua, etc.*, 62 N. H. 413, 13 Am. St. Rep. 578.

⁴ See "Estoppel" in this work.

⁵ *Freyburg v. Los Angeles Brew. Co.*, 4 Cal. App. 114, 38 Pac. 378.

⁶ *Strop v. Hughes*, 123 Mo. App. 547, 101 S. W. 146; *B. S. Green Co. v. Blodgett*, 159 Ill. 169, 42 N. E. 176, 50 Am. St. Rep. 146.

⁷ *Bliss v. Harris*, 38 Colo. 72, 87 Pac. 1076; *Leggett v. New Jersey, etc. Co.*, 1 N. J. Eq. 541, 23 Am. Dec. 728; see note 64 Am. St. Rep. 260.

⁸ *Allen v. Alston*, 147 Ala. 609, 41 South. 159.

It would seem, then, in order to determine the scope of power of a particular corporation to make contracts that it is necessary to determine from the Articles of Incorporation its express and implied powers; second, to determine if the statute of the state under whose laws the corporation is organized permits a corporation to exercise and enjoy such powers and privileges as are set forth in the Articles of Incorporation; in other words if the powers as enumerated in the Articles of Incorporation are authorized by the governing statute; and third, if the contract is within the express or implied powers of the corporation or such as may be necessary for the purpose of carrying into effect such express or implied powers.

§ 84. **Execution of contracts.**—It has been pointed out heretofore that a corporation is a separate and distinct entity from the stockholders or members thereof, with powers, rights and privileges of its own, which powers, rights and privileges do not in any sense belong to the individual members, or stockholders thereof.

It necessarily follows, therefore, that the acts of the stockholders or members of the corporation are not the acts of the corporation itself and can not bind the corporation. Under this rule subject to certain exceptions hereinafter noted, a contract to be binding upon the corporation must be the act of the corporation through its duly authorized, or apparently authorized officers or agents.

Contracts should be authorized by the board of directors or other managing body of the corporation in lawful meeting assembled, in accordance with the pro-

Mt. Coal Min. Co. v. Williams, 37 Colo. 193, 85 Pac. 844; State ex rel. Morrell v. Superior Court, 33 Wash. 542, 74 Pac. 686; Dahl v. Mont. Copper Co., 132 U. S. 264, 33 Law. Ed. 325; McKinley v. Wheeler, 130 U. S. 630, 32 Law. Ed. 1048; Doe v. Waterloo Min. Co., 70 Fed. 455; Thomas v. Chisholm, 13 Colo. 105, 21 Pac. 1019; Princeton v. Bank, 7 Mont. 530, 19 Pac. 210.

on behalf of the corporation by any person purporting to represent it prior to its existence.⁸

While it has been held that in the absence of charter or statutory provisions a contract made on behalf of a corporation before incorporated is a nullity, and that the corporation cannot ratify or adopt the same,⁹ a more liberal view is now taken by the courts holding that a contract made on behalf of a corporation prior to its incorporation may be ratified or adopted by it when organized, and that when such contract is so ratified or adopted, the corporation is liable both at law and in equity on the contract itself and not merely for the benefits received.¹⁰

Generally speaking, contracts made on behalf of the corporation prior to incorporation should be determined and acted upon at the organization meeting of the corporation, at which time the corporation should

⁸ *Morrison v. Gold Mt., etc. Co.*, 52 Cal. 306; *Hawkins v. Mansfield Gold, etc. Co.*, 52 Cal. 513; *Ruby Chief Min., etc. Co. v. Gurley*, 17 Colo. 199, 29 Pac. 668; *Stevenson v. Dubuque, etc. Min. Co.*, 34 Iowa, 577; *Hecla Cons. Gold Min. Co. v. O'Neill*, 19 N. Y. S. 592; *Bash v. Culver Gold Min. Co.*, 7 Wash. 122, 34 Pac. 462; *Winters v. Hub Min. Co.*, 57 Fed. 287; *Tuttle v. Geo. A. Tuttle Co.*, 101 Me. 287, 64 Atl. 496, 8 A. & E. Ann. Cases, 260; *Bradford v. Metcalf*, 185 Mass. 205, 70 N. E. 40; *Munson v. Syracuse, etc. R. Co.*, 103 N. Y. 58, 8 N. E. 355; *Chilcott v. Wash., etc. Co.*, 45 Wash. 148, 88 Pac. 113; *Fred Macey Co. v. Macy*, 143 Mich. 138, 106 N. W. 722, 5 L. R. A. (N. S.) 1036; *Compare Girard v. Case Bros. Cut. Co.*, 225 Pa. 327, 74 Atl. 201; *Kimmerle v. Dowagiac, etc. Co.*, 159 Mich. 34, 123 N. W. 565.

⁹ *Abbott v. Hapgood*, 150 Mass. 248, 22 N. E. 907, 5 L. R. A. 586, 15 Am. St. 193; *Bradford v. Metcalf*, 185 Mass. 205, 70 N. E. 40.

¹⁰ *Shrewsbury v. North Staffordshire R. Co.*, L. R. 1 Eq. 593, 12 Jur. N. S. 63; *Caledonian, etc. R. Co. v. Helensburgh Harbour Trustees*, 5 Jur. N. S. 695, 2 Macq. H. L. 391; *Vauxhill Bridge Co. v. Spencer*, Jac. 64, 2 Madd. 357; *Clarke v. Omaha, etc. R. Co.*, 5 Neb. 314; *Munson v. Syracuse, etc. R. Co.*, 103 N. Y. 58, 8 N. E. 355; see also *Preston v. Liverpool, etc. R. Co.*, 5 H. L. Cas. 605, 1 Sim. N. S. 586, 7 Eng. L. & Eq. 124; *McArthur v. Times Printing Co.*, 48 Minn. 319, 51 N. W. Rep. 216; *Central Trust Co. v. Lappe*, 216 Pa. St. 549, 65 Atl. 1111; *Bond v. Pike*, 101 Minn. 127, 111 N. W. 916; *Possell v. Smith*, 39 Colo. 127, 88 Pac. 1064.

either adopt such contracts by a formal resolution of the directors, or let it be known that the benefits arising under such contracts will not be accepted by the corporation.

An understanding of the disposition of such contracts at this time will often eliminate trouble and misunderstanding after the corporation has started in business. The law is unquestionably well settled in this country, at least, to the extent that contracts of the nature under discussion may be accepted by formal resolution of the directors or by the corporation receiving and accepting the benefits of such contracts after full knowledge of the conditions thereof, or by acquiescence of the corporation.

So too, the law is well settled that a corporation can not accept and retain the benefits of contracts made in its behalf prior to its incorporation without taking on itself the liabilities and burdens thereof.¹¹

§ 86. **Contracts of an extraordinary nature.**—Generally speaking unless special restrictions are made in the governing statute, charter or by-laws, the power and authority of the board of directors to make contracts for the corporation is very extensive. Thus it has been repeatedly held that the board of directors has power to do any and all things necessary to carry into effect the powers as granted them either in the charter or by-laws of the corporations. However there is a certain class of contracts that authority to make must come from the stockholders.

It has been held that directors will not be permitted to sell and dispose of the corporate assets for their own

¹¹ Carter v. Gray, 79 Ark. 273, 96 S. W. 377; Smith v. Parker, 148 Ind. 127, 45 N. E. 770; Alexander v. Winters, 23 Nev. 475, 49 Pac. 116; Chilcott v. Wash. St. Colonization Co., 45 Wash. 148, 88 Pac. 113.

use and benefit,¹² and in the absence of special charter or statutory permission the board of directors has no authority or power to increase or decrease the capital stock of the corporation;¹³ nor can they amend the Articles of Incorporation;¹⁴ nor have they authority generally speaking to consolidate, reorganize or merge with other corporations;¹⁵ nor dissolve the corporation, nor wind up the corporate business;¹⁶ nor sell and dispose of the entire property and assets of the corporation;¹⁷ nor release subscribers to the capital stock;¹⁸ nor make, alter or repeal the by-laws.¹⁹

Many other instances might be cited, but enough are here given to illustrate the character of contracts under discussion. Where there is any doubt as to the right of directors of a corporation to make the particular contract in question, the board of directors will always find it safer and better to call a stockholders' meeting and have them authorize the proposed action. In other words the board of directors should never assume liabilities and responsibilities incident to the undertaking to make some contract in the name of the corporation beyond their power and authority to make, as this will often involve the directors in serious litigation and fasten upon them liabilities for their action.

The directors are under a strict degree of accountability for their *ultra vires* or unlawful acts. Of course

¹² Haines Min. Co. v. Highland Coal Mines Co., 88 Pac. 865; McIver v. Young Hdw. Co., 144 N. C. 478, 57 E. S. 169.

¹³ Chicago, etc. Co. v. Allerton, 18 Wall. U. S. 233; Eldman v. Bowman, 58 Ill. 444, 11 Am. Rep. 90; Nashua, etc. Co. v. Boston, etc. Co., 27 Fed. 821.

¹⁴ Eldman v. Bowman, 58 Ill. 444, 11 Am. Rep. 90.

¹⁵ State v. Steele, 37 Minn. 427; Colgate v. U. S. Leather Co. et al., 73 N. J. Eq. 72, 72 Atl. 126.

¹⁶ Jones v. Bank, 10 Colo. 464, 17 Pac. 272.

¹⁷ See "Sale of Corporate Property."

¹⁸ Gathright v. Oil City Land, etc. Co., 56 S. W. 163.

¹⁹ Morton Gravel Road Co. v. Wysong, 51 Ind. 4.

where the directors do some act in the corporate name beyond their power as directors, but within the power of the corporation, their acts may be made legal by subsequent ratification by the stockholders.²⁰

So too, it has been held that such contracts may be ratified by acquiescence on the part of the corporation.²¹ Therefore we repeat, while the power and authority of the board of directors to bind the corporation in contracts is very extensive, in all contracts of an extraordinary nature, or in contracts effecting a change in the corporation itself, authority for the making thereof should be given by the stockholders in lawful meeting assembled.

§ 87. Validity of corporate contracts in which directors have a personal interest.—Closely related to the rights, duties and liabilities of the promoter are the rights, duties and liabilities of the directors and trustees of a corporation. This is so by reason of the fact that both stand in a fiduciary relation to the corporation, and its stockholders and directors to a higher degree of accountability than the promoters. Indeed it often happens that the persons constituting the promoters before incorporation, become its directors and trustees after incorporation. There is, in that event, imposed upon them by law, the liability imposed by law upon the promoters and the directors. The law from time immemorial has been settled, beyond debate or question, that a director or trustee is not permitted to occupy a position which will conflict with the interest of the corporation he represents. He cannot, as a di-

²⁰ *Miller v. Wash. Southern R. Co.*, 11 Wash. 414, 39 Pac. 673; *Beach v. Miller*, 130 Ill. 162, 22 N. E. 464, 17 Am. St. Rep. 291; *Starr v. Gregory Cons. Min. Co.*, 6 Mont. 485, 13 Pac. 195; *Blake v. Domestic Mfg. Co.*, 38 Atl. 241; *Pitcher v. Lone Pine, etc. Co.*, 39 Wash. 608, 81 Pac. 1047.

²¹ *Miller v. Wash. Southern R. Co.*, 11 Wash. 414, 39 Pac. 673.

rector acquire a personal interest in the trust or corporate property. In short, a director, generally speaking, is not qualified to act for the corporation in any transaction where he has a personal interest in the contract. It is, of course, his duty to faithfully and honestly discharge his trust for the sole benefit of the corporation and its stockholders. The question of the validity and effect of contracts made by directors having a personal interest in the transaction with the corporation he represents, has been the cause of a flood of litigation in both English and American courts, until nearly every jurisdiction of the United States has had occasion to pass upon such contracts in some form. The earlier decisions held such contracts absolutely void *ab initio*, refusing to permit contracts of this nature to be enforced, or made the basis of an action in court, either at law or in equity.²² This somewhat harsh and rigid rule, however, gradually gave way to what is believed to be the better and more wholesome rule under all circumstances, that is, that such contracts are not void *per se*, except where the vote of the directors, or trustees interested in the transaction was necessary to secure the passage of the resolution authorizing the transaction, or, where their presence was necessary to constitute a quorum for the transaction of business; but in a majority of cases and under nearly all circumstances, such contracts are voidable at the option of the corporation, or its stockholders. There is no question under the law, that where the vote of the trustee or director interested in the transaction was necessary

²² *Thomas v. Brownville R. Co.*, 2 Fed. 877, 109 U. S. 522, 27 Law. Ed. 1018; *Haywood v. Lincoln Lumber Co.*, 64 Wis. 639, 26 N. W. 184; *Gardner v. Ogden*, 22 N. Y. 327, 78 Am. Dec. 192; *Port v. Russell*, 36 Ind. 60, 10 Am. Rep. 5; *Pickett v. School District*, 25 Wis. 551, 3 Am. Rep. 105; *People v. Township Board*, 11 Mich. 222; *Wilbur v. Lynde*, 49 Cal. 290, 19 Am. Rep. 645; *Hoffman Steam Coal Co. v. Cumberland Coal Co.*, 16 Maryland, 456, 77 Am. Dec. 311.

to pass the resolution authorizing the contract to be made, the contract will be held to be absolutely void and of no effect. So too, the law is well settled that, the same rules which preclude an interested director from uniting with other directors in the creation of an obligation in favor of himself by his vote, forbid him from uniting with them in creating such obligation, by any act or exercise of his official position, and a meeting at which there is not a majority of the directors exclusive of such interested director is not a competent board for the transaction of any corporate business.²³ That the rule just announced is more wholesome and based upon sound public policy must be conceded. It is based first upon the legal principle that in order to make an express contract, there must be the meeting and assent of two separate, individual minds, and that no man can effectually make a contract with himself; and any contrivance which reduces or attempts to reduce two parties representing different interests into one, is a fallacy against the policy of the law and will not be tolerated or permitted. It is based, second, upon the old equitable doctrine and rule, which restricts the power of directors, or trustees, of a corporation from dealing with the corporation as individuals, being an application of the broad and general rule, which prohibits agents, trustees, executors and all other persons sustaining fiduciary relations, from so dealing with the subject of their trust as to derive some per-

²³ *Curtin v. Salmon, etc. Min. Co.*, 130 Cal. 345, 80 Am. St. Rep. 132, 62 Pac. 552; *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 531; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Van Hook v. Somerville Mfg. Co.*, 5 N. J. Eq. 137; *Wheelwright v. St. Louis Co.*, 56 Fed. 164; *Kelly v. Newberyport Co.*, 141 Mass. 496, 6 N. E. 745; *Copeland v. Johnson Mfg. Co.*, 47 Hun. 235; *Parsons v. Tacoma Smelter Co.*, 25 Wash. 492, 67 Pac. 765; *Martin v. Santa Cruz*, 4 Ariz. 171, 36 Pac. 36; *U. S. Ice Co. v. Reed*, 2 How. P. R. (N. S.) 253; *Butts v. Woods*, 37 N. Y. 317; *Beach v. Miller*, 130 Ill. 162, 17 Am. St. Rep. 291, 22 N. E. 464.

sonal benefit therefrom. Courts from time immemorial have recognized that man is not infallible, but that he is liable to weaken to the bid of the strong temptation of personal gain and profit. Even more, they have presumed, and rightly so, that he would ordinarily take advantage, if permitted; and to prevent wrongs from being done, and crimes from being committed, they have said: "The rule is founded in the known weakness of human nature, and the peril of permitting any sort of collusion between personal interests of the individual and the duties of the trustee in his fiduciary capacity."²⁴ "The wise policy of the law has therefore put the sting of disability into the temptation as a defensive weapon against the strength of the danger which lies in the situation." This language, and the strong language used in many of the courts in illustrating the dangers incident to contracts of this kind are especially applicable to mining corporations. In fact, it is notorious in mining operations that when a rich and valuable mine is found, there is often an attempt made by the controlling interest of the corporation to freeze out the minority stockholders, and this is often done by contracts made with the directors of the corporation, or with their immediate friends or relatives. Innumerable authorities might be cited sustaining the rule of law just announced. We cite well selected cases in the notes.²⁵

²⁴ *Hatch v. Hatch*, 9 Best. 297.

²⁵ *Munson v. Syracuse Ry. Co.*, 103 N. Y. 58, 8 N. E. 355; *Mosher v. Sinnott*, 20 Colo. App. 454, 79 Pac. 742; *Morgan v. King*, 27 Colo. 539, 63 Pac. 416; *Glengary Min. Co. v. Boehemer*, 28 Colo. 1, 62 Pac. 839; *McConnell v. Com. Min., etc. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703; *Parsons v. Tacoma Smelter Co.*, 25 Wash. 492, 67 Pac. 765; *Goodsell v. Verduga*, 138 Cal. 308, 71 Pac. 354; *Jackson v. McLean*, 36 Fed. 213; *Wardell v. U. P. Ry. Co.*, 103 U. S. 651, 26 Law. Ed. 509; *Benseik v. Thomas*, 66 Fed. 104, 13 C. C. A. 457; *U. S. Steel Corp. v. Hodge*, 64 N. J. Eq. 807, 54 Atl. 1; *Mitchell v. United Box, etc. Co.*, 66 Atl. 938; *Pacific Vinegar Co. v. Smith*, 145 Cal. 352, 78 Pac. 550, 104 Am. St. Rep. 53; *Curtin v. Salmon River Co.*, 130

The above rule announced to the effect that directors cannot lawfully enter into a contract where they have a personal interest therein, is subject to some exceptions. Thus, contracts for services in the management of the affairs of the corporation outside of his duties as a director, are said to be valid, but subject always to judicial review so far as the amount of compensation is concerned.²⁶ So too, it has been held, "That while a director of a joint stock company occupies a fiduciary relation where his dealings with the subject matter of his trust and with the company are viewed with jealousy by the courts, and may be set aside on slight grounds, yet one director among several might loan money to the corporation, when the money is needed and the transaction is open and otherwise free from blame, and might buy at a sale under a mortgage given to him by the company to secure the money loaned, if the sale was a fair one."²⁷ A few of the courts have gone to the extent of holding that such contracts are neither void nor voidable, but that they are simply subject to severe scrutiny by the courts, and will be set aside and nullified upon the slightest indication of fraud or unfair dealing.²⁸ While this rule of law in

Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *Tatun v. Eglanol Min. Co.*, 42 Mont. 475, 113 Pac. 295; *Wickersham v. Crittenden*, 93 Cal. 17, 28 Pac. 788; *Pearson v. Concord Ry. Co.*, 62 N. H. 537, 13 Am. St. Rep. 591; 10 Cyc. 809, 810; *Pomeroy's Equity Jurispr.* 3 Ed. § 1094; *Pierce on Railroads*, 36; 1 *Story on Equity Jurisprudence*, § 322; 4 *Kent's Commentaries*, 437; *Clark & Marshall on Private Corp.*, vol. 3, § 758; 1 *Perry on Trusts*, 4 Ed., § 207; *Bigelow on Fraud*, 217; *Morawetz on Corporations*, § 517; 21 *Am. & Eng. Enc. of Law*, 2 Ed. 900; *Cook on Corporations* (5th Ed.), § 653; 3 *Thompson's Commentaries on the Law of Corporations*, § 468.

²⁶ *Mitchell v. United Box Board, etc. Co.*, 66 Atl. (N. J.) 938.

²⁷ *Law et al. v. Fuller*, 66 Atl. 754; see also *Oil Co. v. Marbury*, 91 U. S. 587, 23 Law. Ed. 328; *Mueller v. Fire Clay Co.*, 183 Pa. 450, 38 Atl. 1009; *Pitcher v. Lone Pine, etc. Min. Co.*, 39 Wash. 608, 81 Pac. 1047.

²⁸ *Beach v. McKinnon*, 148 Fed. 734; *Flannigan Bank v. Graham*.

many instances facilitates the business of corporations, yet it must be said that it gives too much latitude to the board of directors, and is liable to be abused and serious frauds result therefrom.

While it is to be conceded that the tendency of the courts is to permit wider latitude to the directors of corporations than formerly was given, and while they seek in every instance to facilitate the business of corporations, and to place their dealings, as much as possible, on the same plane as the dealings of an individual; yet it must be said that some of the courts go to the extent of permitting too much latitude in corporate transactions. To these courts we cannot refrain from commending the language of Judge Buck of Montana: "That a trustee should not be allowed to profit by his trust is a well-known fundamental doctrine of equity. No evasions, no technical subtlety of reasoning, no empty distinctions, should be tolerated when the assertion of this principle becomes necessary. It is true that when the motives of a trustee in the neglect of his duty are not essentially bad, or are readily reconcilable with ordinary honesty of purpose, certain courts have applied this rule leniently. It is true that, when no patently willful violation of duty appears, many judges have shown a disposition to check its force. It is true that weak toleration from the bench of frail, but penitent humanity, has often apparently robbed the principle of its very life. But such precedents serve only to increase plausible devices for evading its consequences. They encourage the natural tendency of designing selfishness to substitute the vague expression 'business enterprise' for 'business honesty.' "

The supreme court of New York says: "It obviously is, or may be, impossible to demonstrate how far, in

42 Ore. 403, 71 Pac. 137; Clark & Marshall on Corporations, 2304; 10 Cyc. 810, 811.

any particular case, the terms of such a contract have been the best for the interests of the *cestui que trust* which it was possible to obtain. It may sometimes happen that the terms on which a trustee has dealt, or attempted to deal, with the estate or interests of those for whom he is a trustee have been as good as could be obtained from any other person; they may even at the time have been better, but still, so inflexible is the rule, that no inquiry on that subject is permitted." ²⁹

"The philosophy of this rule," says the supreme court of California, "is quite apparent, and its inflexibility is the strongest safeguard which the law can offer for the protection of the interests of the beneficiary. The great purpose of the law is to secure fidelity in the agent. When one undertakes to deal with himself in different capacities, individual and representative, there is a manifest hostility in the position he occupies. His duty calls upon him to act for the best interests of his principal; his self-interest prompts him to make the best bargain for himself. Humanity is so constituted that when these conflicting interests arise, the temptation is usually too great to be overcome, and duty is sacrificed to interest. In order that this temptation may be avoided, or, if indulged in, must be at the peril of the trustee, it has been wisely provided that the trustee shall not be permitted to make, or enforce, any contract arising between himself as trustee, and individually, with reference to any matter of trust, nor will the court enter into any examination of the honesty of the transaction." ³⁰

Innumerable cases might be cited sustaining this rule of law. We cite in the note cases illustrating the reasons for the adoption of this rule.³¹ The reasons for

²⁹ *Aberdeen Ry. Co. v. Blakie*, 1 Macq. H. L. 461.

³⁰ *Pacific Vinegar, etc. Wks. v. Smith*, 145 Cal. 352, 78 Pac. 550, 104 Am. St. Rep. 42.

³¹ *Glengary Consolidated Min. Co. v. Boehmer*, 28 Colo. 1, 62 Pac.

the exclusion of all inquiry into the *bona fides* of the transaction are well, fully and ably discussed and expressed in those cases. "It is to avoid the necessity of any such inquiry in which justice might be balked that the rule takes so general a form," says the supreme court New York in *Jewett v. Miller*; and that court, further, in the case of *Duncomb v. N. Y. Ry. Co.* says, "The rule is founded in the known weakness of human nature, and the peril of permitting any sort of collision between the personal interests of the individual and his duties as trustee in his fiduciary capacity." Lord Eldon gave as a reason, "that the inquiry is so easily baffled in a court of justice." Lord Harwicke gave as a reason that, "It is not enough for the trustee to say 'You cannot prove any fraud,' as it is in his power to conceal it." Lord Cranworth gave as a reason, "It may sometimes happen that the terms on which a trustee has dealt, or attempted to deal with the estate or interests of those for whom he is trustee, may have been as good as could have been obtained from any other person; they may even, at the time have been better, but still, so inflexible is the rule that no inquiry upon that subject is permitted." Lord Jaffrey of Scotland, as early as 1846 said, "It is now *presumptio juris de jure* that where a person stands in these inconsistent relations of both buyer and seller, there are dangers,

839; *Pacific Vinegar, etc. Wks. v. Smith*, 145 Cal. 352, 78 Pac. 550, 104 Am. St. Rep. 42; *Munson v. Syracuse Ry. Co.*, 103 N. Y. 58, 8 N. E. 355; *Mosher v. Sinnott*, 79 Pac. 742; *Curtin v. Salmon River Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *Wickersham v. Crittenden*, 93 Cal. 17, 28 Pac. 788; *Memphis Ry. Co. v. Woods*, 88 Ala. 630, 7 South. 108, 16 Am. St. Rep. 81; *Port v. Russell*, 36 Ind. 60, 10 Am. Rep. 5; *O'Conner M. M. Co. v. Coosa F. Co.*, 95 Ala. 614, 10 South. 290, 36 Am. St. Rep. 251; *Higgins v. Lansingh*, 154 Ill. 301, 40 N. E. 362; *Hatch v. Hatch*, 9 Best, 297; *Gardner v. Ogden*, 22 N. Y. 327, 78 Am. Dec. 192, 14 Am. Dec. 375; *Pearson v. Concord Ry. Co.*, 62 N. H. 537, 13 Am. St. Rep. 590; 1 *Story Equity Jurisprudence*, § 322; 4 *Kent Comm.* 438; *Pierce on Railroads*, § 36; *Pomeroy's Equity Jurisprudence* (3rd Ed.), § 958.

and it is not relevant to say that it is impossible there could be any in the particular case."

The English authorities on this subject are numerous and uniform. "Nothing less than incapacity is able to shut the door against temptation where the danger is imminent and the security against discovery great."

The great weight of adjudicated cases in the American courts sustain the rule as announced by the English judges. Mr. Pierce in his work on Railroads, *supra*, says, "The rule is so strict that it does not permit, as against the disproving *cestui que trust*, an inquiry into the good faith and fairness of the transaction, which comes within it." Mr. Pomeroy in his late work on Equity Jurisprudence, *supra*, says, "It is entirely immaterial to the existence and operation of this rule that the sale is intrinsically a fair one, that no undue advantage is obtained, or that a full consideration is paid, or even that the price is the highest which could be obtained. The policy of equity is to remove every possible temptation from the trustee. The rule also applies alike where the sale is private, or at auction, where the purchase is made directly by the trustee himself, or indirectly, through an agent, where the trustee acts simply as agent for another person, and where the purchase is made from a co-trustee. Finally, the rule extends with equal force to a purchase made under like circumstances by a trustee from himself." Justice Field, of the United States supreme court, says, "The two positions impose different obligations, and their union would at once raise a conflict between interest and duty; and constituted as humanity is, in a majority of cases, duty would be overcome in the struggle." The supreme court of California says, "These authorities lay down two propositions. First, that an express contract can not be entered into by a director with himself, relative to the trust property; and second, that the

court will not permit any inquiry into the question of the honesty or fairness of the transaction.”³²

§ 88. **Contracts between corporations having a common board of directors.**—Upon the principle of law above stated, it would seem that a majority of the courts hold that, “If the same persons as directors of two different corporations represent both in a transaction, in which their interests are opposed, such transaction may be voided by either corporation, or at the instance of a stockholder in either, without regard to the question of advantage or detriment to either corporation, and no matter how fair and open the transaction may be shown to be.”³³ To the same effect see cases in note.³⁴ On the other hand, it has been held that such contracts are neither void nor voidable, and will not be set aside unless there is some evidence of fraud, bad faith, or unfair dealing.³⁵ It is to be noted that in all of the above cases, the rule is firmly established that such contracts are always open to the severe scrutiny of the courts and will be set aside if there is the slightest indication of fraud or unfair dealings. Finally, the rule has been extended to the extent of affecting contracts, where the directors of one corporation own, or control, a majority

³² *Pacific Vinegar Wks. v. Smith*, 145 Cal. 352, 78 Pac. 550, 104 Am. St. Rep. 42.

³³ *O’Conner Min. & Mfg. Co. v. Coosa Furnace Co.*, 95 Ala. 614, 10 South. 290, 36 Am. St. Rep. 251.

³⁴ *Parsons v. Tacoma Smelt. & Ref. Co.*, 25 Wash. 492, 67 Pac. 765; *Memphis Ry. Co. v. Woods*, 88 Ala. 630, 7 South. 108, 16 Am. St. Rep. 81; *Stokes v. Phelps Mission*, 47 Hun. 570; *Pearson v. Concord, etc. Co.*, 62 N. H. 537, 13 Am. St. Rep. 590; *Sweeney v. Grape Sugar, etc. Co.*, 30 W. Va. 443, 8 Am. St. Rep. 88; *Wardell v. U. P. Ry. Co.*, 103 U. S. 651, 26 Law. Ed. 509.

³⁵ *Aldine Mfg. Co. v. Phillips*, 129 Mich. 240; *Rawlings v. New Memphis, etc. Co.*, 60 S. W. 206; *Robotham v. Prudential Ins. Co.*, 53 Atl. 842; *Manufacturers’ Sav. Bank v. Big Muddy Iron Co.*, 97 Mo. 38, 10 S. W. 865.

of the stock in another corporation, even though they may not be directors of such other corporation.³⁶

Such contracts being merely voidable at the option of the corporation, may be ratified by the corporation, or the stockholders thereof, in which event, of course, they will become binding upon the corporation. Such ratification may be either an express ratification, that is, where the stockholders meet and vote to ratify the contract, or it may be presumed from long continued acquiescence of the corporation.³⁷ Of course where there is an attempted express ratification, to make such ratification binding and conclusive, the principal must be fully advised of every material circumstance of the transaction, the real value of the subject of the contract; and his ratification must be an independent and substantive act, founded upon such complete information.³⁸ Before such contracts can be set aside, or rescinded, it will be necessary to place the contracting parties in their original positions, that is, the corporation must tender back the property received.³⁹ An exception to this general rule exists, where the entire transaction is steeped in actual fraud. Under these circumstances, it would seem that it is not necessary to tender back the consideration.⁴⁰

³⁶ *Wardell v. U. P. Ry. Co.*, 103 U. S. 651, 26 Law. Ed. 509; *Thomas v. Brownville, etc. Co.*, 2 Fed. 877.

³⁷ *U. S. Rolling Stock Co. v. Atl. R. R. Co.*, 34 Ohio St. 450, 32 Am. Rep. 380; *O'Conner Min., etc. Co. v. Coosa Furnace Co.*, 95 Ala. 614, 10 South. 290, 36 Am. St. Rep. 251; *Mackey v. Burns*, 16 Colo. App. 6, 64 Pac. 485; *Beach v. Miller*, 130 Ill. 162, 17 Am. St. Rep. 291, 22 N. E. 464.

³⁸ *Hoffman Steam Coal Co. v. Cumberland C. & I. Co.*, 16 Md. 456, 77 Am. Dec. 311.

³⁹ *Mosher v. Sinnott*, 20 Colo. App. 454, 79 Pac. 742.

⁴⁰ *Gerry v. Bismark Bank*, 19 Mont. 191, 47 Pac. 810.

CHAPTER XIII.

SALE OF CORPORATE PROPERTY.

- § 89. In general.
- 90. Sale of all the corporate property.
- 91. When a corporation is conducting unprofitable business, or in a failing condition.
- 92. Private and *quasi* public corporations.
- 93. Sale should be authorized by stockholders.
- 94. Statutes.
- 95. Consideration that may be received.
- 96. Remedy of dissenting stockholders.
- 97. Rights of creditors.
- 98. Withdrawing corporate assets.

§ 89. In general.—Generally speaking, a corporation has within the scope of its lawful powers, or in due course of its business, the same power to dispose of its property as a natural person. That is, it may purchase, sell and otherwise alienate its real and personal property.¹

Corporations may be said to have an incidental power to dispose of their property, real and personal, either by sale absolute, or by mortgage, or other mode of security for any debt which they may rightfully contract, to the same extent as natural persons, except in so far as their powers may be restrained by their by-laws, by considerations connected with the purpose of their creation, or limited by express provisions, or just implica-

¹ *Miners Ditch Co. v. Zellerbach*, 37 Cal. 543, 99 Am. Dec. 30; *Buell v. Buckingham*, 16 Iowa, 284, 85 Am. Dec. 516; *Dupee v. Boston Water Power Co.*, 114 Mass. 37; *Burton's Appeal*, 57 Pa. St. 213; *White Water, etc. Canal Co. v. Vallette*, 21 Howard, 414, 16 Law. Ed. 154; *Lange v. Reservation Min. & Smelt. Co.*, 48 Wash. 167, 93 Pac. 208; *Pitcher v. Lone Pine, etc. Min. Co.*, 39 Wash. 608, 81 Pac 1047.

tion of some statute, or by the general policy of the state, to be deduced from its legislation.²

There is no escape from the fact that in the very nature of corporate organization, the owners of the majority of the capital stock are in a sense, the corporation itself. The power of this majority, when acting in good faith, and in the interests of all of the stockholders is supreme, provided always, they are acting within the scope of the charter powers. They bind the corporation in all matters of lawful and legitimate administration of the corporate affairs permitted within the purposes of the articles of incorporation. From what already has been said it is seen that the courts have followed the well established rule of law that, "It cannot be denied that minority stockholders are bound hand and foot to the majority, in all matters of legitimate administration of the corporate affairs, and the courts are powerless to redress many forms of oppression practiced upon the minority under the guise of legal sanction, which falls short of actual fraud. This is in consequence of the implied contract of association, by which it is agreed in advance, that a majority shall bind the whole body as to all transactions within the scope of the corporate powers."³

The above rule is believed to be well settled in American courts, even to the extent, in some cases, of being an arbitrary rule with no exceptions. To us it seems that some courts go a long way to sustain the will and rule of the majority, often imposing upon the minority harsh and oppressive rules, in order to sustain this principle. There should be no legal sanction to forms of oppression practiced upon the minority. Arbitrary rules even though sustained by precedence, should give way whenever they inflict oppression, and whenever contrary to equity between man and man. Often this

² Joy v. Jackson & Mich. Plank Road Co., 11 Mich. 155.

³ Ervin v. Oregon, etc. Nav. Co., 27 Fed. 625, 23 Blatchf. 517.

well meaning rule of law will be used to carry out some moral fraud, to the detriment of the minority stockholders. Thus, in our judgment, the rule of law placing in the hands of the majority stockholders, the right to control the corporation, which rule is founded in justice, should require that such control always should be exercised in the interest of every stockholder; that is, we undertake to say that in all questions arising under this rule of law, while recognized principles, in all cases, should be applied and govern, yet the controlling principle should be the just and equitable rights of every stockholder, according to the facts of that particular case. It is believed that justice would be better administered, if courts would pay less attention to so called established precedents, and undertake to adjust each controversy according to equitable principles, taking into consideration everything pertaining to, or in any way connected with, the particular question under consideration.

Thus, in deciding questions under the rule of law just suggested, the general nature of the corporation should be taken into consideration, as well as the fact that it has come to pass that nearly all business enterprises are manned and controlled by corporations. They form an indispensable part of our industrial system. They are no longer looked upon with fear, distrust or disfavor. The remarkable progress made by corporations in the last few years in their development of the resources of the country has exceeded greatly the progress of laws and decisions; hence, the natural consequences have been and are, that laws and decisions are being administered and followed, when as a matter of fact, they were enacted and decided under different circumstances and different rules and customs.

§ 90. **Sale of the corporate property.**—The thing that concerns us most in this chapter is where the corpora-

tion undertakes to dispose of all the corporate property and its assets. The law is well settled that a corporation cannot, against the wishes of a single stockholder, convey away the entire property and assets of the corporation, if such corporation is in a going and prosperous condition.⁴

"The charter invests the owners of a majority of the capital stock with the right to control the corporation business, within the scope of its provisions. Within this limit the power of the majority, when acting in good faith is supreme. But complainant's charter does not by reasonable intendment, clothe the majority with authority to sell the company's franchise and property, and in that way coerce the minority, and protesting shareholders, into another corporation owning and operating another and different railroad, under another and different charter, imposing other and different objects and governed by a different set of corporators. To so hold would be to divest them of their vested rights and force them into a relation, and subject them to duties and obligations, which they have not, and probably would not have voluntarily assumed."⁵ And again, in *Buford v. Packett Co.*, *supra*,⁶ the supreme court of New Jersey says, "Officers of a corporation

⁴ *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 455; *Tanner v. Lindell Ry. Co.*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534; *Buford v. Packett*, 3 Mo. App. 159; *Abbott v. Am. Hard Rubber Co.*, 33 Barb. 578; *Feld v. Roanoke Inv. Co.*, 123 Mo. 603, 27 S. W. 635; *Knoxville v. Knoxville, etc. Co.*, 22 Fed. 758; *Ervin v. Ore., etc. Co.*, 27 Fed. 625, 23 Blatchf. 517; *Price v. Holcomb*, 89 Iowa, 123, 56 N. W. 407; *Clearwater v. Meredith*, 1 Wall. 25, 17 Law. Ed. 604; *Traer v. Lucas Prosp. Co.*, 124 Iowa, 107, 99 N. W. 290; *Cook on Corporations* (5th Ed.), § 670; 10 Cyc. 1138; *Spokane v. Amsterdamsch Trustees Kantoor*, 22 Wash. 172, 60 Pac. 141; *Theis v. Spokane Falls Gas Co.*, 34 Wash. 23, 74 Pac. 1004; *Forrester v. Boston, etc. Min. Co.*, 21 Mont. 544, 55 Pac. 229; *Parsons v. Tacoma Smelting Co.*, 25 Wash. 492, 67 Pac. 765.

⁵ *Knoxville v. Knoxville, etc. Co.* 22 Fed. 758.

⁶ *Buford v. Packett Co.*, 3 Mo. App. 159.

cannot, against the wishes of a single stockholder, convey away the entire property from which the corporation derives its emoluments, and which is essential to the business purposes of its organization. The right of the stockholder in this regard is founded upon contract. He has invested his means upon an agreement with his fellow corporators, that they shall be devoted to promotion of the general objects defined in the charter. He must yield to the will of the majority in whatever conforms to the tenor of this agreement, as being directed to the successful prosecution of the common enterprise. But when asked to submit to a proceeding which effectually annihilates the enterprise and diverts his contribution into a channel never contemplated by him, the courts will protect him to the letter of his reserved rights."

This rule is, of course, founded in justice and equity. More than that, it is founded in the known weakness of human nature. It seeks to protect the weak against the wrongful acts of the strong. However, it is believed that even this rule of law should not be an unqualified one. That the minority should be protected to the letter of their reserved rights does not admit of question or debate, but if the rule that has been established for the protection of the minority is to be construed into a rule of law, with which the minority can harass, distress and "sand bag" the majority, then it is, in that conception, wrong, and should be remedied. That which is intended as a shield, should never be permitted to be used as a sword.

In this age of consolidation, mergers and combinations, very often corporations, although in a measure profitable, could, by consolidation or sale to another corporation, greatly increase their dividends and profits, and enhance the value of their corporate property.

In such cases, some provision should be made to permit the majority to better their conditions. Under the above rule, which seems to be quite well established, persons holding an insignificant amount of stock can either force the majority stockholders, however large they may be, into paying an exorbitant price for their stock, or prevent a transaction that would increase, immeasurably, their profits and enhance greatly the value of the corporate property. Not only that, but the fact is that often a corporation, after receiving and refusing an opportunity to consolidate with another corporation for a common purpose, called a trust, will, after such refusal, be absolutely forced out of business, and the whole enterprise wiped off the map of industrial action by the larger and stronger combination. In that event not only the minority holder who prevented the consolidation and sale, but every stockholder of the corporation is made to suffer financially. Again, in actual practice, small holdings are often secured by competing interests for the sole purpose of harassing and annoying the corporation in all of its transactions.⁷

The state of Montana has very effectively met this condition with a statute providing that two-thirds of the stockholders may sell and transfer the corporate property, and that where one-third, or any portion thereof, are dissatisfied with the sale, they are entitled to have the property appraised and the corporation purchasing such property is bound to pay to such dissenting stockholders the appraised value of their stock. This is fair, equitable and just, and protects alike the majority and the minority.

§ 91. When a corporation is conducting unprofitable business, or in a failing condition.—When the affairs of a corporation are in an unprofitable or failing condi-

⁷ *Forrester v. Boston, etc. Min. Co.*, 21 Mont. 544, 55 Pac. 229.

tion, or where the business of the corporation does not pay its running expenses, the rule seems to be that the majority stockholders have the right to sell and dispose of all the corporate property and assets.⁸ "That is a principle of law founded in justice and is applied to protect the weak against the strong, when the weak is right and the strong is wrong. It is applied to prevent or relieve against an unjust abuse of the power of the majority. It is not an unqualified rule of law. None of the authorities cited say that a sale of all the property of a corporation pursuant to a resolution of a majority of its members is void. They all recognize that the majority in interest have the right to rule within reasonable bounds, and that whilst they have no right, arbitrarily or oppressively, to close out a corporation for their own advantage, yet they are not compelled to continue an unprofitable business, or to pay the minority more than their stock is worth for the privilege of closing it up. The principle invoked by the plaintiffs is wise and just, but, since it is liable to abuse, its wisdom and justice are seen only in its application to the facts of the given case. It is, as before said, designed for the protection of the minority, but like some other equitable principles, it is to be used as a shield, not as a sword. When, therefore, the principle is invoked in a court of equity, the case turns on a question of remedy, the court applies the law *ex aequo et bono*, with due regard to the rights of the plaintiff, and also with

⁸ *Traer v. Lucas Prospecting Co.*, 124 Iowa, 107, 99 N. W. 290; *Price v. Holcomb*, 89 Iowa, 123, 56 N. W. 407; *Doyle v. Leitelt*, 97 Mich. 298, 56 N. W. 553; *Berry v. Broach*, 65 Miss. 450, 4 South. 117; *Abbott v. Am. Hard Rubber Co.*, 33 Barb. 578; *Skinner v. Smith*, 134 N. Y. 240, 31 N. E. 911; *People v. Ballard*, 134 N. Y. 269, 32 N. E. 54, 17 L. R. A. 737; *Patterson v. Portland Smelt. Wks.*, 35 Ore. 96, 56 Pac. 407; *Phillips v. Providence, etc. Co.*, 21 R. I. 302, 43 Atl. 598, 45 L. R. A. 560; *Tanner v. Lindell R. Co.*, 180 Mo. 1, 79 S. W. 155 103 Am. St. Rep. 534.

due regard to the rights of the defendant, and others, whose interests may have become involved. Because all the stockholders have not consented to the sale, it does not follow that the sale will be set aside regardless of the consequences. Sometimes, when the act is stained with bad faith, and only those who are guilty of the wrong are to be affected, the court will set aside the sale and restore the conditions as they were before."⁹ And again, the supreme court of California, in the often cited *Miner's Ditch Co. v. Zellerbach* case,¹⁰ says, "The enterprise of the Miner's Ditch Co. may have proved unprofitable, and rendered it necessary to dispose of its assets and wind up the concern, as the only means of avoiding insolvency. It might be necessary to sell and convey a part, or the whole of its property, in order to raise means to pay its debts, and avoid a sacrifice by forced sale. In either event, the sale and conveyance of the property, with these objects in view would be a lawful purpose of the corporation. Although the object for which it was formed was to construct a ditch, and convey water for sale to miners and for mechanical purposes, there was no obligation resting on the corporation to pursue this object after it became evident that the enterprise would be unprofitable, and result in insolvency or loss. When such a result appears to be unavoidable, obviously, the only mode by which the interests of the parties and of the public could be subserved would be to dispose of its assets in the most advantageous way, and pay off its debts with a view to winding up the affairs of the corporation with the least possible loss."

Of course, where the conditions of the business affairs of the corporation are unprofitable and in a fail-

⁹ *Tanner v. Lindell Ry. Co.*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534.

¹⁰ *Miner's Ditch Co. v. Zellerbach*, 37 Cal. 543, 99 Am. Dec. 300.

ing condition, brought about by wrongful and fraudulent acts for the purpose of carrying out some unlawful plan or scheme, courts should refuse to permit a consummation of this scheme. In other words, where it is necessary to commit a fraud to accomplish a certain purpose, the consummation of that purpose should be prevented by the courts.

§ 92. **Private and quasi public corporations.**—There is a distinction existing, in law, between strictly private corporations and *quasi* public corporations, when it comes to the sale of property and assets of such corporation.¹¹ Thus, the supreme court of the United States has said, "Where a corporation like a railroad company has granted to it by charter a franchise intended in a large measure to be exercised for the public good, the due performance of those functions being the consideration of the public grant, any contract which disables the corporation from performing those functions which undertakes, without the consent of the state, to transfer to others the rights and powers conferred by the charter, and to relieve the grantees of the burden which it imposes, is a violation of the contract with the state, and is void as against public policy."¹² In other words, it is now generally held that in such corporations, legislative authority is necessary to authorize a sale or mortgage of their properties. Such a rule, of course, has no application to strictly private corporations, but is confined wholly to *quasi* public corporations.

¹¹ *Johnson v. Miller*, 174 Pa. St. 605, 52 Am. St. Rep. 833, 34 Atl. 316; *Gue v. Tidewater Canal Co.*, 24 Howard, 257, 16 Law. Ed. 635; *Thomas v. R. R. Co.*, 101 U. S. 85, 25 Law. Ed. 950; *State v. Western, etc. Co.*, 40 Kan. 96, 19 Pac. 349, 10 Am. St. Rep. 166; *Pearce v. Madison Add. R. Co.*, 21 Howard, 441, 16 Law. Ed. 184.

¹² *Thomas v. R. R. Co.*, 101 U. S. 85, 25 Law. Ed. 950.

§ 93. Sale should be authorized by stockholders.—The sale should always be properly authorized by the stockholders of the corporation in lawful meeting called and held. The notice calling the meeting, even though it be the regular annual meeting, should advise the stockholders of the intended sale, and of course, care must be taken to see to it that the notice is given in accordance with the terms of the by-laws to each stockholder. Sometimes it will be found advisable to include in the notice the consideration to be received for the property, and state whether the corporation is to receive cash, or stock or bonds in another corporation.

Again, special care should always be taken that the resolution fully authorizes the sale as the same is afterwards made, as the resolution is the foundation of the sale. Thus, where the stockholders' resolution authorizes the sale for cash, the directors could not sell on any other terms.¹³ So, too, where authority is given to sell to a corporation, the sale cannot be made to an individual about to form a corporation.¹⁴

Usually the law of the state wherein the property is situated must be complied with in making the sale.¹⁵ This question of course would only arise where the corporation is organized under the laws of one state and its property located in another. Generally speaking, the board of directors has no power to authorize the sale of all the property of the corporation.¹⁶ However, their acts in so doing may be ratified by the stockholders if the stockholders themselves had, under the

¹³ *Patterson v. Portland Smelt. Co.*, 35 Ore. 96, 56 Pac. 407.

¹⁴ *Byrde v. Byrde Co.*, L. R. 9, chap. 388.

¹⁵ *Fowler v. Bell*, 90 Tex. 150, 37 S. W. 1058, 59 Am. St. Rep. 788, 39 L. R. A. 254; *Williams v. Gold Hill Min. Co.*, 96 Fed. 454.

¹⁶ *Consolidated, etc. Co. v. Nash*, 109 Wis. 490, 85 N. W. 485; *Stokes v. Pottery Co.*, 46 N. J. L. 237; *Tappan v. Bank*, 127 Mass. 107; *Good-year Rubber Co. v. Geo. D. Scott Co.*, 96 Ala. 439, 11 South. 370.

law, the right to authorize such sale. The directors of course will not be permitted to ratify their own acts.¹⁷

§ 94. **Statutes.**—The statutes of California and Montana provide that mining and other corporations, desiring to sell all or part of their property are first required to call a stockholders' meeting for the purpose of authorizing such sale, and if stockholders representing at least two-thirds of the whole number of shares of the capital stock of the corporation then outstanding shall vote in favor of such sale at such meeting, the officers of the corporation are thereby authorized to sell and transfer the property.

The statute in this case outlines fully the contents of the notice to be given, how it shall be served upon the stockholders, and the method of calling and conducting the meeting generally. It is necessary to set out fully in the notice sent to the stockholders, whether the whole, or only a part of the property of the corporation is to be sold, mortgaged or disposed of, and whether it is to be sold for cash, or stock, or bonds in another corporation. The statute further provides that, "Any stockholder who is not at the stockholders' meeting having voted for or authorized the provision or resolution for the disposal of the property, which may be adopted at such stockholders' meeting may, within twenty days after the date of said stockholders' meeting, give notice to the said corporation that he does not assent thereto, and, also, a like notice to the grantee or vendee, or any agent or representative of such grantee or vendee, and demand payment of the value of his stock, and within ten days after service

¹⁷ *Duke v. Markham*, 105 N. C. 131, 18 Am. St. Rep. 889, 10 S. E. 1017; *McArthur v. Times Printing Co.*, 48 Minn. 319, 31 Am. St. Rep. 653, 51 N. W. 216; *Lyndon Mill Co. v. Lyndon, etc.*, 63 Vt. 581, 25 Am. St. Rep. 783, 22 Atl. 575.

of said notices he must, or the said corporation, or grantee, or vendee may make application in the district court of the county where the principal place of business of the corporation is situated, to have the value of his stock fixed and appraised, of which application there must be ten days' previous notice given by the persons so applying to the other parties." The law then provides that it shall be the duty of the appraisers to meet at the time and place designated by the court, and to decide upon the value of the stock of the dissenting stockholder, and return and file their report in appraisement with the clerk of said court. The vendee of the property is then bound to pay to such dissenting stockholder such appraised value, or appeal from the award and appraisement, and bring the question for settlement to the attention of a jury in the county wherein the property is situated.

Massachusetts also has a similar statute. That such statutes must be complied with by all domestic corporations, is of course settled. However, whether a foreign corporation owning property in one of these states is required to comply with such laws, or if it is sufficient to comply with the laws of the state wherein the corporation is incorporated, is a mooted question. The general rule of law is, that all conveyances of property must conform to the laws of the state of the *situs* of the property.¹⁸

It should always be remembered that the laws of the state wherein the corporation is operating and is seeking to enforce its contracts must be complied with by a foreign corporation. On the other hand, it has been

¹⁸ *Fowler v. Bell*, 90 Tex. 150, 37 S. W. 1058, 59 Am. St. Rep. 788, 39 L. R. A. 254; *Williams v. Gold Hill Min. Co.*, 96 Fed. 454; *Thomson v. Kyle*, 39 Fla. 582; *Union Natl. Bank v. Natl. Bank*, 155 Mo. 95, 78 Am. St. Rep. 560, 55 S. W. 989; *McGarry v. Nicklin*, 110 Ala. 559, 55 Am. St. Rep. 40.

held that such laws are passed for the purpose of prescribing, to a certain extent, rules for the internal government of corporations, and that such laws will not be extended to foreign corporations unless the intention so to do is clearly expressed by such statute.¹⁹ The state of Montana has not yet passed upon this question, but it would seem that the case of *Williams v. Gold Hill Mining Co.*, *supra*, settled that question in the California jurisdiction. On the other hand, the supreme court of Michigan in *Salt Marsh v. Spaulding*, *supra*, where the validity of a mortgage authorized by the board of directors of a foreign corporation was in question, held that their statute applied only to domestic corporations, and sustained the validity of the mortgage. Where a New York corporation, insolvent, had mortgaged land in New Jersey to a stockholder, such a mortgage being contrary to the laws of the state of New York, where the corporation was organized, but valid according to the state of New Jersey where the property was situated, the mortgage was upheld.²⁰

In Texas, where an insolvent corporation created under the laws of the state of Iowa and domiciled and owning property in the state of Texas, authorized the execution of a mortgage in Iowa on the property that was located in Texas; which act was contrary to the laws of the state of Texas, but valid under the laws of the state of Iowa where the same was executed, it was held to be valid.²¹ But the court in discussing the validity of this mortgage in this case, says: "Applying these principles of law to the facts of this case, it follows that, if the mortgage in question was made con-

¹⁹ *Salt Marsh v. Spaulding*, 147 Mass. 224, 17 N. E. 316.

²⁰ *Vanderpoel v. Gorman*, 140 N. Y. 563, 35 N. E. 932, 24 L. R. A. 548, 37 Am. St. Rep. 601.

²¹ *Fowler v. Bell*, 90 Tex. 150, 59 Am. St. Rep. 788, 37 S. W. 1058.

trary to the laws of this state, or to its public policy, it is void, and conferred no rights upon the mortgagee. A corporation created in this state, which has become insolvent, and has ceased to carry on its business, cannot make any disposition of its property which gives a preference to one or more creditors over others, for the reason that, upon insolvency and cessation of the business, the assets of the corporation by operation of the law become a trust fund in the hands of its directors to be disposed of for the benefit of its creditors, and any disposition which discriminates between such creditors is a violation of that trust. *Lang v. Dougherty*, 74 Texas, 226; *Hardware Co. v. Perry Stove Mfg. Co.*, 86 Texas, 143.

“If the McLeod Artesian Well Co. had been a domestic corporation, and had made the mortgage in question under the same conditions, it would be void because contrary to the laws and public policy of this state, as declared in the decision of its court as above cited; and it must be so held in this case, unless its validity can be supported upon the ground that it is sustained by the laws of the state of Iowa.” To the same effect see also note.²²

The Michigan statute prohibiting mining corporations from selling or alienating any of their mines, works or real estate or franchises applies only to such property as is necessary to enable the corporation to successfully carry on its business, and has no application to non-mineral lands located in another county.

²² *Nathan v. Lee*, 152 Ind. 232, 52 N. E. 987, 43 L. R. A. 820; *Warren v. First Natl. Bank*, 149 Ill. 9, 38 N. E. 122, 25 L. R. A. 746; *Pairpoint Mfg. Co. v. Philadelphia Opt. & Watch Co.*, 161 Pa. 17, 28 Atl. 1003; *East Side Bank v. Columbus Tanning Co.*, 170 Pa. 1, 32 Atl. 539; *Borton v. Brines-Chase Co.*, 175 Pa. St. 209, 34 Atl. 597; see also upon this question, *Pearce v. Crompton*, 13 R. I. 312; *Barth v. Backus*, 140 N. Y. 230, 37 Am. St. Rep. 545, 35 N. E. 425, 23 L. R. A. 47; *Faulkner v. Hyman*, 142 Mass. 53.

Of course, as already has been suggested, a corporation has a right to sell or dispose of property in due course of business, and these statutes do not undertake, in any way, to interfere with that right. The majority stockholders may even make an assignment of all the property of the corporation where insolvent, for the benefit of the creditors.²³

From what already has been said, it will be seen that where a corporation is organized under the laws of one state, and owns or holds property in another, and desires to sell the same, that the better and safer plan under all circumstances is to comply with the laws of the *situs* of the property, the laws of the state in which the corporate property is located, for it seems that the weight of authority and the better law sustains this proposition.

§ 95. **Consideration that may be received.**—We have heretofore noted that a majority of the stockholders cannot, against the consent of the minority, convey away all the corporate property of a going and solvent corporation. Eliminating now for the purpose of this chapter the question of authority of the stockholders to sell and dispose of the corporate property, we come to the question of whether or not, in the event that they are allowed to sell, they can accept as payment for such property anything but cash.

The question will often arise whether or not a corporation can sell or dispose of its property, and accept stock or bonds in another corporation, which is usually the corporation purchasing the property. In this age of consolidation, mergers and reorganizations, it is a common practice to sell all of the property belonging to the corporation to a new corporation, and to accept

²³ *Boyton v. Roe*, 114 Mich. 401, 72 N. W. 257; *Wright v. Lee*, 2 S. D. 596, 51 N. W. 706.

as payment therefor stock and bonds in the new concern, which in turn are offered to and distributed among the stockholders of the old corporation.²⁴ Of course where all the stockholders join in the transfer, there can be no question if the creditors have been properly cared for.²⁵ In the well considered and often cited case of *Tanner v. Lindell Ry. Co.*, *supra*, the consideration for the property transferred was stock in the new corporation, and while the court refused to compel the dissenting stockholders to accept their *pro rata* part of stock, it nevertheless refused to set the transaction aside. However, the law seems to be well settled that dissenting stockholders cannot be compelled to accept stock or bonds in other corporations in exchange for their stock or property rights.

This rule is the natural consequence of the broad and general rule that courts will not impose upon persons against their will and without their consent a new contract. This rule of law is believed to be well founded. Later decisions upon this question seem to be drifting to the establishment of the rule that dissenting stockholders are not entitled to have the transaction set aside. "If the majority of stockholders, against the will of the minority, sell all of the property of the corporation and thereby work a practical dissolution of it, the minority are not bound to take in payment of their stock a *pro rata* share of the proceeds of the sale, or, in substitution therefor, the stock of another corporation, but at their election may have out of the proceeds of the sale, whether it be money or other property, the market value of their stock at the date of the sale, or their pro-

²⁴ *Tanner v. Lindell Ry. Co.*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534; *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 523; *Beling v. Am. Tobacco Co.* (N. J.), 65 Atl. 725; *Boynnton v. Roe*, 114 Mich. 401, 72 N. W. 257.

²⁵ *Tanner v. Lindell Ry. Co.*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534.

portionate share of the proceeds, or they may follow the property into the hands of the purchaser and share in the proceeds arising from its use in the same ratio that they would have shared if the sale had not been made; and if the transaction be made in bad faith, they may, under some circumstances, have the sale set aside."²⁶

It has been held that an arrangement by which a corporation of the state of New Jersey was to sell and transfer all of its property to a corporation organized under the laws of the state of Washington, and for which property they were to receive 20,000 shares of paid up stock of a New Jersey corporation of a par value of \$100 each, or in case of the unwillingness of any stockholder to exchange his shares for an equal number in the Washington corporation, then the Washington corporation was to pay the New Jersey corporation \$35 cash for each share held by the non-assenting stockholder, in lieu of an equal number of shares in the Washington corporation, would be enjoined at the suit of a stockholder of the New Jersey company, since it amounts to a dissolution of the New Jersey corporation, which can be effected only in the manner prescribed by statute, and since under the laws of Washington it is unlawful to issue stock as fully paid up, unless the corporation received therefor money or money's worth face value of the stock.²⁷ This case further holds that under the laws of the state of Washington, the corporation could not purchase, hold or vote the stock of another corporation.

It is to be noted, in passing, that the last objection

²⁶ *Tanner v. Lindell Ry. Co.*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534.

²⁷ *Coler v. Tacoma, etc. Co.*, 65 N. J. Eq. 347, 54 Atl. 413, 103 Am. St. Rep. 786; see also *Elyton Land Co. v. Dowdell*, 113 Ala. 177, 20 South. 981, 59 Am. St. Rep. 105.

is now eliminated, by statute, in the state of Washington, permitting the corporation to purchase stock in other corporations. Finally, it will be seen, in concluding this question, that while the law is probably well settled that a stockholder will not be compelled to accept stock, or bonds, in another corporation in exchange for his stock and property rights,²⁸ yet where proper provision has been made to take care of his interests and he is given an opportunity to share fairly and equitably in the profits received from the property, and he fails and refuses to take his *pro rata* part of the stock received, and provision has been made to pay him the face value of his stock at the time of the sale in question, and the transaction is free from fraud and bad faith, it is very doubtful if he can have the transaction set aside, or the property returned to the corporation.

It would seem that this is only a fair and just rule of law, when proper consideration is allowed for all of the circumstances connected with the transaction, together with due allowance for a reasonable and legitimate scope to corporations. There can be no doubt that the old idea of absolute and legal rights of minority stockholders is gradually giving way to the more sensible rule of giving to them such rights as are fair, equitable and just under the circumstances of a given case. There can be no justice in establishing, or maintaining, a rule of law that permits the minority stockholders to prevent the majority from acting to the best interests of the corporation and its stockholders. The laws of trade demand safer and more liberal decisions

²⁸ *Tanner v. Lindell Ry. Co.*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534; *Lauman v. Lebanon, etc. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; *Feld v. Roanoke Inv. Co.*, 123 Mo. 603, 27 S. W. 635; *Morris v. Elyton Land Co.*, 125 Ala. 263, 28 South. 513; *Byrne v. Schuyler, etc. Co.*, 65 Conn. 336, 31 Atl. 833, 28 L. R. A. 304.

in this regard, and of course the courts will in time recognize this.

In a late case in the supreme court of the state of Washington, that court held that where the articles of incorporation provided that the corporation had a right to sell and dispose of its property, the board of directors might, under this provision, sell and dispose of all of the property and assets of the corporation.²⁹

§ 96. **Remedy of dissenting stockholders.**—From what already has been said, it will be readily understood that formerly the courts held, subject to certain exceptions to the proposition of law, that the property of a corporation must be used to carry on the business for which it was created, and that it was unlawful for the majority to undertake to sell and dispose of the entire corporate property, without the unanimous consent of its stockholders, and that where such an attempt was made to sell and dispose of its property and assets, and thereby render it incapable of doing business, it would be prevented by injunction.³⁰ And if the sale already had been completed and the property transferred, the same would be set aside, and the property ordered turned back to the corporation. The harshness of this rule, however, has gradually given way, and now a number of courts are not only taking into consideration the rights of the plaintiff, but also the rights of the defendant. The supreme court of Missouri in *Tanner v. Lindell Ry. Co.*, *supra*, says: "Plaintiffs concede in their argument that if the corporation had been insolvent, or running its business at a loss, the majority of the stockholders would have had the

²⁹ *Lange v. Reservation Min. & Smelt. Co.*, 48 Wash. 167, 93 Pac. 208.

³⁰ *Hayden v. Official Hotel, etc. Co.*, 42 Fed. 875; *Treadwell v. United Verde Copper Co.*, 62 N. Y. S. 708; *Lewishon v. Anaconda Copper Co.*, 51 N. Y. S. 1089; *Harding v. Am. Glucose Co.*, 182 Ill. 551, 55 N. E. 577, 74 Am. St. Rep. 189.

right to sell its property and close it up. That concession recognizes a discretion to be exercised by the majority in taking action to avert loss. To what extent that discretion may be exercised may be a question for the court in a given case. It is said that if the corporation is doing business at a loss, the majority may close it out. But suppose it is not running at an actual loss, yet at a profit so small that, in the judgment of the majority, the capital invested is not yielding what it should, and from a business standpoint it should be diverted into a channel that promises better results, is there no discretion lodged in the majority to act in such emergency? Here was an investment of more than \$2,000,000 earning a dividend of five per cent per annum. The petition says that after the purchase of the property of the Lindell company, and that of other street railroad companies, the United Railways Company increased its capital stock from \$5,000,000 to \$45,000,000 and issued mortgage bonds to the amount of \$45,000,000 aggregating liabilities to the amount of \$90,000,000, with the result that the company, which is composed of the same individuals who sold the property of the Lindell, received as the proceeds of the transaction a net gain of \$57,744,900, a large share of which those individuals appropriated to themselves. In the face of those figures the plaintiffs do not aver that the transaction on the whole was a bad business venture, or that the stockholders of the Lindell who participated in it were damaged; and they do not say that they were denied the privilege of participating in it on equal terms with those who did.

“They ask that the sale be set aside, and that the Lindell company be rehabilitated in its former property, and set to work under its own charter. This they ask, not upon a showing that any wrong has really been done them; not that the transaction was not fair

and profitable; not that they were not afforded an opportunity of participation in it to the same extent that was accorded the most favored, but upon the bare naked legal proposition that it is a violation of the implied contract between the stockholders *inter sese* to sell the property of the corporation so as to disable it from doing business without the consent of all. To concede to the plaintiffs the right to annul the sale under those conditions would be to place the holder of one share of stock in position to dictate to the majority the terms on which a sale might be made, giving him an advantage which reason and justice cannot approve. That is not the law.

“If, under those circumstances, the sale was a breach of the implied contract, the courts of law are open to the plaintiffs to sue for damages for the injury, but there is nothing in the case to arouse a court of equity into action. If the court should grant the plaintiffs’ request and set aside this sale, who can foresee the consequences that might result? What would become of the interests of those people who may have invested in the \$45,000,000 of stock of the United Railways Company, or those who may have invested in the mortgage bonds, or in the stock of the Transit Company? If the deed from the Lindell Company to the United Railways Company be set aside, all the investments that may have been made on the faith of that deed must fail.

“It is not necessary in order to redress the plaintiffs’ wrongs that any such remedy be applied. They are entitled to recover in a proper proceeding the value of their stock at the time of its conversion, if they elect to consider it a conversion, or they are entitled, if they so prefer, to have the same proportion of United Railways stock given to them in exchange for their Lindell stock that was given to the individual

defendants in exchange for theirs, or if they prefer to hold their Lindell stock they may have their proportion of the earnings of the Lindell property in the hands of the United Railways Company, or the Transit Company, but they are not entitled to pull down the whole new structure that has been built upon the properties that have been transferred to the United Railways Company under the circumstances stated in the petition."

In the supreme court of New Jersey in the case of *Beling v. American Tobacco Co.*,³¹ Pitney, V. C., says, "Now, I conceive that the case presented is one in which the court is thoroughly justified in refusing to give specific performance. It is well settled that the court will not in all cases grant specific performances. It is always, in a sense, a matter of judicial discretion. The difficulty of specifically performing the contract and its effect and consequences to the parties, comparative injury to the one party and the benefit to the other are to be taken into consideration." Of course where the transaction is tainted with fraud, or stained with bad faith, and only those who are guilty of the wrong are affected, then the court will not hesitate to set the whole transaction aside as was done in *Abbott v. American Hard Rubber Co.*³²

Thus we say in conclusion that it would seem that in the absence of fraud, actual or constructive, and in the absence of an unfair advantage toward the minority stockholders, and especially where the rights of innocent third persons have not interfered, such minority stockholders are not entitled to have the transaction set aside, and a specific performance decreed, but that they may either have their *pro rata* share of the proceeds

³¹ *Beling v. Am. Tobacco Co.*, 72 N. J. Eq. 32, 65 Atl. 725; see also *Spear v. Erie Ry. Co.*, 68 N. J. Eq. 619, 60 Atl. 197; Pomeroy on Specific Performance, § 303.

³² *Abbott v. Am. Hard Rubber Co.*, 33 Barb. 578.

from such sale, whether it be money or property, or they may sue the corporation for conversion, for the market value of their stock at the date of the sale, or they may follow the property into the hands of the purchaser and share in the profits arising from its use, in the same ratio that they would have shared if the sale had not been made. This is especially true where the property has been sold to a corporation, and such corporation after the purchase of such property has sold and disposed of stock to the innocent investing public.

We cannot refrain from saying that generally speaking, the minority stockholders representing a small per cent of the entire outstanding stock of the corporation will usually find little relief in the courts, when complaining of a sale of the corporate property, unless the transaction is tainted with fraud or bad faith, or sold by the manipulating majority to favor their own individual interests. It is believed that such minority will find that it always is advisable when the transaction is not tainted with fraud or bad faith, to quietly submit to the judgment of the majority, and share with them in the proceeds of the sale of the property. Litigation of this kind will be found to be expensive, often bitter and long drawn out. Indeed it is not uncommon to see a corporation completely bankrupt, before the questions arising pro and con are settled and determined by the courts, and even after such questions have all been settled and the minority have succeeded in restoring to the corporation the property formerly transferred, it again falls into the hands and under the control of the majority, encumbered with necessary debts of litigation, and in an unorganized and demoralized condition, and usually does not long survive receivership. Where the transaction is one planned and carried out by the majority for the sole purpose of "freezing out" the minority, thus depriving them

of their property and rights by schemes and manipulations, the minority will find that they must fight for their rights or be wholly deprived thereof. While such a practice is a legal and moral fraud, and to be regretted, it is a practice that is sometimes indulged in by majority stockholders.

Under such circumstances, it is generally believed that it is as well for the minority to secure an appointment of a receiver and thus endeavor to wind up the corporate business. Where the property transferred is sold to a corporation composed of the stockholders holding a majority of the outstanding stock of the vendor corporation, then the courts will scrutinize such contracts and sales with much greater care than if made to a third party or to a corporation composed of other and different members.

The court in *Mumford v. Ecuador Development Co.*³³ commenting upon this question says, "Although a majority may lawfully make a contract with the company, such contract will be scrutinized with much greater care than if made with a third party, and unless it appears that it was made honestly, and for an adequate consideration, the court of equity will interpose to prevent such contract from being used oppressively and in violation of the rights of the minority. It matters not in what form these rights are invaded; it is the business of equity to penetrate through subterfuges and discover the actual transaction, stripped of all disguises. If then it shall appear, no matter what may be the machinery employed, that the majority have sold the corporate property to themselves for a wholly inadequate consideration, a court of equity will grant relief to the minority, who have thus been despoiled of their property."

³³ *Mumford v. Ecuador Development Co.*, 111 Fed. 639.

Some courts hold that, when one person has the power to dispose of the property of another without the consent of the latter, he is not allowed to become personally interested in it himself, without regard to any question of fairness in the transaction. He is not allowed to occupy a position where self-interest would tempt a betrayal of duty. And it is illegal and fraudulent for a majority stockholder to purchase the property of the corporation at a sale authorized by himself, and such purchase will be set aside in the same way and to the same extent that a purchase of the corporate property by a director may be set aside at the instance of the minority stockholders.³⁴

§ 97. **Rights of creditors.**—We have heretofore noted that the property of a corporation, in a sense, is a trust fund held for the benefit of the creditors. There can be no distribution of this fund among the stockholders, unless some provisions have first been made for the payment of the corporate debts, and any disposition of it in fraud of the creditors would be void.³⁵ This is so whether the corporation is solvent or insolvent.³⁶

³⁴ *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 320, 30 N. E. 667, 33 Am. St. Rep. 315; Quoting Cook on Corporations; see also *Alexandra v. Searcy*, 81 Ga. 536, 8 S. E. 630, 12 Am. St. Rep. 337; *Sears v. Hotchkiss*, 25 Conn. 171, 65 Am. Dec. 557; *Rothwell v. Robinson*, 39 Minn. 1, 12 Am. St. Rep. 608, 38 N. W. 772; *Meeker v. Winthrop Iron Co.*, 17 Fed. 48; *Ervin v. Ore., etc. Co.*, 20 Fed. 577; *Brewer v. Boston Theatre*, 104 Mass. 378.

³⁵ *McIver v. Young Hdw. Co.*, 144 N. C. 478, 57 S. E. 169, 119 Am. St. Rep. 970; *Hospes v. N. W. Mfg. Co.*, 48 Minn. 174, 31 Am. St. Rep. 637, 50 N. W. 1117, 15 L. R. A. 470; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Darcy v. Brooklyn, etc. Co.*, 196 N. Y. 99, 89 N. E. 461, 134 Am. St. Rep. 827; *J. I. Kelley Co. v. Pollock & Bernheimer*, 57 Fla. 459, 49 South. 934, 131 Am. St. Rep. 1101; *Wooten v. Steele*, 109 Ala. 563, 55 Am. St. Rep. 947; *Portland Con. Min. Co. v. Rossiter*, 16 S. D. 633, 94 N. W. 702, 102 Am. St. Rep. 726; *Mundy v. Jacques (Md.)*, 81 Atl. 289.

³⁶ *Hollins v. Brierfield, etc. Co.*, 150 U. S. 371, 14 Sup. Ct. 127, 37 Law. Ed. 1113.

In this sense not only the corporate property, but the unpaid stock subscriptions to its capital stock constitute a trust fund for the benefit of the creditors, and such creditors of the corporation are entitled to have their claims paid and debts discharged prior to any payment to the stockholders.³⁷

A disposal of all the corporate property does not *ipso facto* dissolve nor end the corporate existence.³⁸ Therefore, the trustees, even after the sale of the entire assets and property of the corporation continue to be trustees of the creditors for certain purposes.³⁹ Generally speaking, a corporation that is insolvent may make an assignment for the benefit of the creditors, if done in good faith.⁴⁰ So, too, a corporation generally speaking, though insolvent, may prefer its creditors where it has possession and control of its property, and the transaction is free from fraud, and is not contrary to some statute. They may prefer such creditors even to the extent of a mortgage, sale or assignment, or deed of trust.⁴¹ It is to be noted, how-

³⁷ *Fogg v. Blair*, 139 U. S. 118, 35 Law. Ed. 104; *Sawyer v. Hoag*, 17 Wall. 610, 21 Law. Ed. 731; *New Albany v. Burke*, 11 Wall. 96, 20 Law. Ed. 155; *Ames v. U. P. R. Co.*, 74 Fed. 335; *Coleman v. Howe*, 154 Ill. 458, 39 N. E. 725, 45 Am. St. Rep. 133; *Cole v. Millerton Iron Co.*, 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615; *Beach v. Miller*, 130 Ill. 162, 22 N. E. 464, 17 Am. St. Rep. 291; *Buck v. Ross*, 68 Conn. 29, 35 Atl. 763, 57 Am. St. Rep. 60; *Burch v. Taylor*, 1 Wash. 245, 24 Pac. 438.

³⁸ *Reichwald v. Hotel Co.*, 106 Ill. 439; *Lange v. Reservation Min. & Smelt. Co.*, 48 Wash. 167, 93 Pac. 208.

³⁹ *Clark v. San Francisco*, 53 Cal. 306.

⁴⁰ *Descombes v. Wood*, 91 Mo. 196, 4 S. W. 82, 60 Am. Rep. 239; *Vanderpoel v. Gorman*, 140 N. Y. 563, 35 N. E. 932, 24 L. R. A. 548, 37 Am. St. Rep. 601.

⁴¹ *Hawkins v. Glenn*, 131 U. S. 319, 33 Law. Ed. 184; *Butler Paper Co. v. Robins*, 151 Ill. 588, 38 N. E. 153; *Varnum v. Hart*, 119 N. Y. 101, 23 N. E. 183; *Meyer v. Folding Chair Co.*, 130 Mo. 188, 32 S. W. 300; *Pyles v. Furniture Co.*, 30 W. Va. 123, 2 S. E. 909; *Johnson Co. v. Miller*, 174 Pa. St. 605, 34 Atl. 316, 52 Am. St. Rep. 833; *Ill. Steel Co. v. O'Donnel*, 156 Ill. 624, 41 N. E. 185, 47 Am. St. Rep. 245; *West*

ever, that there are some exceptions to the rule of law just announced.

Mr. Wait in his work on insolvent corporations,⁴² uses the following very vigorous language upon this question: "The rule that the property of a corporation is a trust fund, to be applied for the equal benefit of all its creditors, is, as we have seen, constantly struggling for recognition in the cases. The funds of a corporation may be regarded as pledged exclusively for the payment of the debts of the corporation. The private property of the stockholders is not liable, nor is there at common law any individual responsibility on the part of the directors for corporate obligations. The corporate property is, then, the sole source to which the creditors must resort. The assets, as we have seen, might properly be considered as a special fund or property set apart in law in lieu of the private property of the corporators, to which resort may be had for the payment of the debts of the corporation. The directors and managers of an insolvent corporation are regarded as trustees of the corporate funds, and for that reason should make a *pro rata* distribution among the various creditors, and hence it has been held that the trustees will not be permitted to prefer debts for which they are themselves personally liable. The struggle, both in the statutes and in the cases, has been to suppress preferences, which are justly regarded as a crying evil with which our insolvency and bankruptcy laws seem inadequate to cope. A court of equity, it may be observed, will interfere and appoint

v. Hanson Co., 6 Colo. App. 467, 41 Pac. 829; Sabin v. Col. Fuel Co., 25 Ore. 15, 34 Pac. 692, 42 Am. St. Rep. 756; Rollins v. Shaver Wagon Co., 80 Iowa, 380, 45 N. W. 1037, 20 Am. St. Rep. 427; La Grange, etc. Co. v. Natl. Bank, 122 Mo. 154, 26 S. W. 710, 43 Am. St. Rep. 558; Worthen v. Griffith, 59 Ark. 562, 28 S. W. 286, 43 Am. St. Rep. 50.

⁴² Wait on Insolvent Corporations, § 162.

a receiver of a bank when the officers have been making preferential payments. While the existence of the right of a failing debtor to prefer one creditor to another in the distribution of his property has often been regretted, it is recognized both in courts of law and of equity. Cases may be cited upholding the right of a corporation, unrestricted by statute, to make a preferential assignment. The rule is quite firmly established. The practical working of the rule sustaining corporate preferences is monstrous. The unpreferred creditors have only a myth or a shadow left to which resort can be had for payment of their claims; a soulless, fictitious, unsubstantial entity that can neither be seen nor found. The capital and assets of the corporation, the creditors' trust fund, may, under this rule, be carved out and apportioned among a chosen few, usually the family connections or immediate friends of the officers making the preference. This rule of law is entitled to take precedence among the many reckless absurdities to be met with in the cases affecting corporations, as being a manifest travesty upon natural justice."

The supreme court of Washington, commenting upon this question, says: "And so it is with the corporations in this state, parties who deal with these corporations under the law rely exclusively upon the funds of the corporation, recognizing the fact that they have no redress upon the private means of the stockholders; and every principle of fair dealing demands, under such circumstances, that the fund upon which they rely and to which they extend their credit should be held as a sacred trust, and equitably and justly distributed by the court for their benefit."⁴³ The general rule

⁴³ *Conover v. Hull*, 10 Wash. 673, 39 Pac. 166, 45 Am. St. Rep. 810; see also *Rouse v. Merchants' Bank*, 46 Ohio St. 493, 22 N. E. 293, 5

settled by the great weight of authority is to the effect that directors of an insolvent corporation, being in law trustees of the creditors, are barred, by virtue of their relation to the creditors, from preferring debts due to themselves from the corporation. In other words, directors cannot use the assets of the corporation to pay their own debts and claims, and exclude from consideration the creditors, but the creditors in such a case are entitled to preference,⁴⁴ and where the business of the corporation is known to its officers to be a losing one, and the creditors of such corporation are pressing it, it being unable to pay, and actions are instituted by near relatives or members of the corporation through the procurement of one of them, a judgment thus secured will be regarded as a collusive preference and as such denied effect.⁴⁵

It is to be noted, however, that the general rule just announced to the effect that the corporation cannot prefer its directors or officers over the general creditors of the corporation, also has its exceptions. The supreme court of Missouri⁴⁶ has held that a corporation in control of its property, though insolvent, may, when acting honestly, prefer its stockholders and officers, who are *bona fide* creditors of such corporation. Commenting upon this proposition that court said,

L. R. A. 378, 15 Am. St. Rep. 644; Lyons-Thomas Hdw. Co. v. Perry Stove Mfg. Co., 86 Tex. 143, 24 S. W. 16, 22 L. R. A. 802.

⁴⁴ Warren v. First Natl. Bank, 149 Ill. 9, 38 N. E. 122, 25 L. R. A. 746; Olney v. Conanicut Land Co., 16 R. I. 597; 27 Am. St. Rep. 767; Corey v. Wadsworth, 99 Ala. 68, 11 South. 350, 23 L. R. A. 618, 42 Am. St. Rep. 29; Adams v. Kehlor Mill Co., 35 Fed. 433; N. W., etc. Co. v. Cotton, etc. Co., 70 Fed. 155; Consolidated Tank Line Co. v. Kan. City Var. Co., 45 Fed. 7; Buck v. Ross, 68 Conn. 29, 35 Atl. 763, 57 Am. St. Rep. 60; Smith v. Los Angeles, etc. Co., 78 Cal. 289, 20 Pac. 677, 12 Am. St. Rep. 53.

⁴⁵ Conover v. Hull, 10 Wash. 673, 39 Pac. 166, 45 Am. St. Rep. 810.

⁴⁶ Schufeldt v. Smith, 131 Mo. 280, 31 S. W. 1039, 29 L. R. A. 830, 52 Am. St. Rep. 628.

“But it cannot be said as a correct proposition of law that officers of a corporation cannot themselves and in their own name contract with it. To so hold would virtually deny to corporations the credit upon which so much of the business of the country is transacted, and which is essential to success. If the stockholders and officers of corporations are not permitted to advance money to them, or to endorse for them without subjecting themselves to such disadvantages, they would be deprived of their most valuable source of credit.”

A corporation naturally looks to those interested in its affairs for accommodations. If directors can lend the corporation money and endorse for it, they should certainly have the same right to collect the debts and secure themselves as is accorded other creditors. “If the debt be an honest one and the corporation had the power to contract it, it has the right to pay or secure it, and no fraud can be imputed to it from the fact that it is paid or secured in preference to another.” Judge Callewell in his opinion in *Gould v. Little Rock R. Co.*⁴⁷ commenting upon this question says, “The doctrine established by the best considered cases and by the supreme court of the United States is, that the mere fact that creditors of a corporation are directors and stockholders, does not prevent their taking security to themselves as individuals to secure a *bona fide* loan of money previously made to such corporation, and used by it in conducting its legitimate business.”

Judge Taft, in a case before the United States circuit court of appeals for the sixth circuit comes to the same conclusion in this language: “It may be conceded that the trust relation justifies and requires courts of

⁴⁷ *Gould v. Little Rock, etc. R. Co.*, 52 Fed. 680.

equity to subject preferences by an insolvent corporation of its own directors to the closest scrutiny; and places the burden upon the preferred director of showing beyond question that he had a *bona fide* debt against the corporation; but we do not see why, if a corporation may prefer one creditor over others, it may not prefer a director who is a *bona fide* creditor. Preferences are not based upon any equitable principle. They go by favor, and as an individual may prefer among his creditors his friends and relatives, so a corporation may prefer its friends."⁴⁸ Notwithstanding this array of authorities sustaining the rule that an insolvent corporation may prefer some creditors to others, even though such creditors are among its directors, it is believed that those authorities holding that a valid assignment cannot be made for the benefit of the creditors in an insolvent corporation, where such creditors are directors of the corporation, and where directors have by an endorsement made themselves liable personally on obligations of the corporation, preference may be given them is the better law.⁴⁹

⁴⁸ *Brown v. Grand Rapids, etc. Co.*, 58 Fed. 286, 7 C. C. A. 225, 22 L. R. A. 817; among the other authorities that sustain this proposition the following are cited—*Buell v. Buckingham*, 16 Iowa, 284, 85 Am. Dec. 516; *Garrett v. Burlington Plough Co.*, 70 Iowa, 697, 29 N. W. 395, 59 Am. Rep. 461; *Bank of Montreal v. Potts Salt & Lumber Co.*, 90 Mich. 345, 51 N. W. 512; *Hospes v. N. W. Mfg. Co.*, 48 Minn. 174, 50 N. W. 1117, 15 L. R. A. 470, 31 Am. St. Rep. 637; *Planters' Bank v. Whittle*, 78 Va. 737; *Hallam v. Indianola Hotel Co.*, 56 Iowa, 178, 9 N. W. 111; *Smith v. Skeary*, 47 Conn. 47; *Wilkinson v. Bauerle*, 41 N. J. Eq. 635, 7 Atl. 514; *Duncomb v. N. Y., etc. Ry. Co.*, 84 N. Y. 190; *Worthen v. Griffith*, 59 Ark. 562, 28 S. W. 286, 43 Am. St. Rep. 50; *Butler v. Harrison Land & Min. Co.*, 139 Mo. 467, 41 S. W. 234, 61 Am. St. Rep. 464; *Schufeldt v. Smith*, 131 Mo. 280, 31 S. W. 1039, 29 L. R. A. 830, 52 Am. St. Rep. 628; *Corey v. Wadsworth*, 118 Ala. 488, 25 South. 503, 44 L. R. A. 766.

⁴⁹ *Hudreson v. Ind. Trust Co.*, 143 Ind. 561; *Brown v. Grand Rapids, etc. Co.*, 58 Fed. 286, 7 C. C. A. 225, 22 L. R. A. 817.

So also, it has been held that directors may give preference to a relative.⁵⁰ Transfers of corporate property and assets made in contemplation of insolvency are void as to creditors,⁵¹ and a sale of the property of an insolvent corporation made for the purpose of hindering delaying or defrauding creditors is void as to them.⁵² A corporation cannot defeat its just debts by transferring all of the property of the corporation.⁵³ The assets of a corporation which has permanently ceased to do business or to even exercise its franchises, are thereby converted into a trust fund for the benefit of its creditors.⁵⁴

Where a corporation has sold and disposed of all the corporate property and assets, or so manipulated the transaction as to deprive creditors of their just claims, such property may be pursued by such creditors into the hands of all persons, except actual *bona fide* officers or creditors,⁵⁵ and in some cases the directors who have authorized the transfer of the property of the corporation, will be liable to the persons injured.⁵⁶ So where the property of the corporation has been conveyed to a new corporation without properly providing

⁵⁰ Blair v. Ill. Steel Co., 159 Ill. 350, 42 N. E. 895, 31 L. R. A. 269.

⁵¹ Natl. Broadway Bank v. Wessel Metal Co., 59 Hun (N. Y.), 470, 13 N. Y. S. 744.

⁵² Ashhurst's Appeal, 60 Pa. St. 290.

⁵³ Cole v. Mill Iron Co., 133 N. Y. 164, 30 N. E. 847, 28 Am. St. Rep. 615; Chattanooga, etc. Co. v. Evans, 66 Fed. 809, 14 C. C. A. 116; Mish v. Main, 81 Md. 36, 31 Atl. 799; J. I. Kelley Co. v. Pollock & Bernheimer, 57 Fla. 459, 49 South. 934, 131 Am. St. Rep. 1101; McIver v. Young Hdw. Co., 144 N. C. 478, 57 S. E. 169, 119 Am. St. 970.

⁵⁴ Voightman & Co. v. Southern Ry. Co., 131 S. W. 982.

⁵⁵ Curran v. State, 15 How. 304, 14 Law. Ed. 705; Fogg v. Blair, 139 U. S. 118, 35 Law. Ed. 104; Clark v. Bever, 139 U. S. 96, 11 Sup. Ct. 468, 35 Law. Ed. 88; Luedecke v. Des Moines, etc. Co., 140 Iowa, 223, 118 N. W. 456; Hubbard v. United Wireless, etc. Co., 115 N. Y. S. 1016; Boyd v. Northern Pac. Ry. Co., 170 Fed. 779.

⁵⁶ Atl. Real Estate Co. v. Atl. Natl. Bank, 75 Ga. 40; Ellis v. Pullman, 95 Ga. 445, 22 S. E. 568.

for the discharge of the debts and obligations of the old corporation, the creditors may follow the property into the hands of the new corporation, provided that the rights of the innocent persons have not intervened.⁵⁷ It generally is believed that stockholders who purchase stock in the new corporation without knowledge will be regarded as innocent purchasers.

§ 98. **Withdrawing corporate assets.**—Nearly all of the states have statutes prohibiting the withdrawal or division of the corporate assets unless the creditors are cared for. As heretofore has been said, the assets of a corporation are in a certain sense to be regarded as a trust fund and the officers as occupying a position of fiduciaries in respect to their duties towards creditors, charged with the preservation and proper distribution of those assets. The corporate debts must be paid before they can appropriate any part of the assets to their own use though they may also be stockholders. The fund for the payment of dividends and to be distributed among the stockholders is what is left after the corporate debts have been paid. It is true as between itself and its creditors, a corporation may be regarded simply as a debtor; still, as between its creditors and its stockholders, its assets are considered in equity as a trust fund for the payment of debts and cannot be diverted from that purpose for the benefit of the latter no matter what the form of the transaction by which the scheme of the transfer is consummated.

“It is needless to enter upon any elaborate discussion of what is known as the ‘trust-fund doctrine’ in order to define its true nature and to fix its limitations, for it is quite sufficient for the purpose of deciding this

⁵⁷ *Vance v. McNabb, etc. Co.*, 92 Tenn. 47, 20 S. W. 424; *McIver v. Young Hdw. Co.*, 144 N. C. 478, 57 S. E. 169, 119 Am. St. Rep. 970.

case, that, as a part of that important doctrine, we find it to be settled that the stockholders and officers of the corporation are liable to it and to its creditors for any acts of malfeasance, misfeasance or nonfeasance, by which their rights are injuriously affected, and, as a consequence, for any loss arising out of their fraud or negligence. If they have served themselves, directly or indirectly, instead of serving the corporation when their interests and those of the corporation or of its creditors conflict, they must answer for any loss resulting from their faithlessness and cupidity. While there is no direct and express trust attached to the corporate property for the benefit of its creditors, so that its assets cannot be conveyed by it or acquired by another except they be subject, in the hands of the purchaser, to the burden of a trust or lien, and therefore they can properly be called a trust fund only 'by way of analogy or metaphor;' and while, as between itself and its creditors, the corporation may be regarded as simply a debtor, still, as between its creditors and its stockholders, its assets are considered in equity as a fund for the payment of debts and cannot be diverted from that purpose for the benefit of the latter, no matter what the form of the transaction may be by which the scheme of diversion is consummated."⁵⁸

⁵⁸ *McIver v. Young Hdw. Co.*, 144 N. C. 478, 57 S. E. 169, 119 Am. St. Rep. 970; *Corbett v. Woodward*, 5 Sawy. 403; *Sawyer v. Hoag*, 17 Wall. (U. S.) 610, 21 Law. Ed. 731; *Atlanta & Walworth Butter & Cheese Ass'n v. Smith*, 141 Wis. 377, 123 N. W. 106, 135 Am. St. Rep. 42; *Darcy v. Brooklyn, etc. Ferry Co.*, 196 N. Y. 99, 89 N. E. 461, 134 Am. St. Rep. 827; *Handley v. Stutz*, 139 U. S. 417, 35 Law. Ed. 227.

CHAPTER XIV.

CONSOLIDATION, MERGER, AND RE-ORGANIZATION.

- § 99. Generally.
- 100. Definitions.
- 101. Reorganization.
- 102. Rights of dissenting stockholders.
- 103. Rights of creditors.

§ 99. **Generally.**—Our observations on these subjects will be limited to a few suggestions which are believed to be of assistance to corporations desiring to consolidate or re-organize. We are living in an age of consolidation. It is a common occurrence to see a number of smaller corporations uniting their interests in a larger and more powerful one in a way beneficial to the stockholders of all such smaller concerns and very beneficial to the promoters of the consolidating scheme.

The United States Steel Corporation practically controlling the steel product of the United States; the American Tobacco Company; the American Snuff Company; and the Sugar and Leather trusts are examples.

If the progress in industrial combination for the quarter of a century can be taken as a guide, then the next quarter of a century will see industrial combinations larger in magnitude and still more far reaching in effect than the colossal combinations of the present.

§ 100. **Definitions.**—“The consolidation of corporations is a combination of two or more existing corporations, by an agreement between them, under legislative authority, under which the old corporations are dissolved, and a new corporation created, or one cor-

poration is continued, and the other or others are merged in it.”¹

While consolidation and merger are used interchangeably in many of the reported cases there is a clear distinction between them. “A merger,” said the supreme court of Mississippi, “rightly understood, is not the equivalent of consolidation at all but exists where one of the constituent companies remains in being, absorbing or merging in itself all the other constituent companies.”²

The first necessary requisite to valid consolidation is legislative authority. It is not sufficient that no limitation is found forbidding such a process, but the right to consolidate must be conferred expressly, or by necessary implication, or it does not exist. Statutory authority authorizing consolidation will be found in the general corporation acts of the several states. Some, however, are more or less limited. While there are decisions to the contrary,³ it would seem that the better rule is that statutes authorizing consolidation are subject to the same rules of construction as are implied in the general incorporation acts; that is, the prerequisite requirements of such statutes must be substantially complied with, and any material omission will be fatal to valid consolidation, especially where attacked in *quo warranto* proceedings by the state.⁴ It is unquestionably true that consolidation has for its primary object the uniting and combining of property interests of corporations already in existence, and in this respect partakes somewhat of the nature of a

¹ Clark & Marshall on Private Corporations, § 347.

² Vicksburg, etc. Telephone Co. v. Citizens' Telephone Co., 79 Miss. 341, 30 South. 725, 89 Am. St. Rep. 656.

³ Black v. Delaware, etc. Co., 22 N. J. Eq. 130.

⁴ State v. Vanderbilt, 37 Ohio St. 590; State v. Chicago, etc. Co., 145 Ind. 229; Brown v. Dibble, 65 Mich. 520, 32 N. W. 656; Mansfield, etc. Co. v. Brown, 26 Ohio St. 223.

transfer to the corporation of an original franchise or charter, yet it is nevertheless true that, by consolidation, a new corporation is brought into existence, and is a distinct entity, which is created and exists alone by virtue of the legislative grant authorizing consolidation, from which grant it gets its existence, life and powers. In other words, a new corporation is created out of the constituent corporations, by the statute authorizing consolidation, which is one of the reasons for applying the rule suggested.⁵ Where the corporations seeking consolidation are created under the laws of different states, it has been held that authority to consolidate must be found in the laws of such states under whose jurisdiction they were created.⁶ So, too, it has been held that authority to consolidate must be given by the charters of all of the constituent corporations.⁷ The contrary rule is announced in *Knoxville v. Knoxville*⁸ upon the theory that an express grant to one corporation to purchase was an implied grant to another corporation to sell. Those decisions are based upon very questionable grounds. The second requisite to valid consolidation is the unanimous consent of the stockholders.⁹ The rule invoked is the principle of law protecting the property rights of every man, as well as preserving unto him the fruits of his lawful contracts. Since the now famous *Dartmouth College* case, corporate charters and franchises are recognized and held to be contracts between the corporation and its stockholders. That a stockholder can not be com-

⁵ *Atlantic, etc. Co. v. Georgia*, 98 U. S. 359, 25 Law. Ed. 185.

⁶ *L. & N. Ry. Co. v. Kentucky*, 161 U. S. 677, 40 Law. Ed. 849.

⁷ *Morrill v. Smith Co.*, 89 Tex. 529, 36 S. W. 56.

⁸ *Knoxville v. Knoxville*, 22 Fed. 758; *N. Y., etc. R. Co. v. N. Y., etc. R. Co.*, 52 Conn. 274.

⁹ *Morrison v. Am. Snuff Co.*, 79 Miss. 330, 30 South. 723, 89 Am. St. Rep. 598; *Kohl v. Lilenthal*, 81 Cal. 378, 20 Pac. 401; *Rabe v. Dunlap*, 51 N. J. Eq. 40, 25 Atl. 959.

pelled to surrender his property rights under this contract, or be required to enter into another without his consent and against his will, is well settled law. "He has invested his means upon an agreement with his fellow corporators that they shall be devoted to the promotion of the general object defined in the charter. He must yield to the will of the majority in whatever conforms to the tenor of this agreement as being directed to the successful prosecution of the common enterprise, but when asked to submit to a proceeding which effectually annihilates the enterprise and diverts his contribution into a channel never contemplated by him, the court will protect him to the letter of his reserved rights."¹⁰

"It is also settled," says the supreme court of New Jersey, "upon the principles of common law in this state, and most of the states of the Union, that when a number of persons become members of a corporation for definite purposes and objects specified in their charter, which in such case is their contract, and for a time settled by it, that the objects and business of the corporation cannot be changed or abandoned, or sold out within the time specified, without the consent of all the partners or corporators; one partner or corporator, however small his interest, can prevent it; and this is so, although by law a majority in either case can control or manage the business against the will and interest of the minority, so long as it is within the scope of the charter."¹¹ The rule is founded on the great principle of protecting every man and his property by contracts entered into. As more fully will be seen hereinafter, a single non-assenting stockholder not

¹⁰ *Buford v. Packet*, 3 Mo. App. 159.

¹¹ *Zabriskie v. Hackensack, etc. Co.*, 18 N. J. Eq. 178, 90 Am. Dec. 617; compare, *Beling v. Am. Tobacco Co.*, 72 N. J. Eq. 32, 65 Atl. 725; *Spear v. Erie Ry. Co.*, 68 N. J. Eq. 619, 60 Atl. 191.

guilty of laches may, by injunction, prevent consolidation. Of course, where the articles of incorporation contain a provision authorizing consolidation, unanimous consent of the stockholders is not required to effect such.¹² It is no defense that consolidation is to the best interests of the corporation, or that the consolidating corporation is ready and willing to pay for the stock of the dissenting stockholder.¹³ However, it has been held that where the stockholders dissenting represent a very small number of the shares of stock, equity might refuse injunction, and merely require security to be given for the payment for the dissenting holder's stock.¹⁴ While a dissenting stockholder is only required to make reasonable haste in instituting his action to prevent consolidation, or to set aside if consolidation has been consummated, if he is guilty of laches and permits the rights of innocent third parties to intervene, he will be precluded from preventing consolidation or setting aside consolidation after it has taken place.¹⁵ The statutes of several states authorizing consolidation, generally prescribe the procedure to effect it; and should under all circumstances be consulted.

§ 101. **Reorganization.**—Reorganization is easily distinguished from consolidation and merger, both in its operation, plan and effect. It does not contemplate the uniting or combining of corporations at all. It has for its purpose the carrying out of some plan or arrangement whereby the affairs of an insolvent corpora-

¹² *Davis v. Congregation, etc.*, 57 N. Y. S. 1015.

¹³ *Nugent v. Putnam Co.*, 19 Wall. (U. S.) 241, 22 Law. Ed. 83.

¹⁴ *McVicker v. Ross*, 55 Barb. (N. Y.) 247; *Lauman v. Lebanon Valley Ry. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; *State v. Bailey*, 16 Ind. 46, 79 Am. Dec. 405; *Beling v. Am. Tobacco Co.*, *supra*.

¹⁵ *Dana v. Am. Tobacco Co.*, 72 N. J. Eq. 44, 65 Atl. 730; *Chapman v. Mad River, etc. Co.*, 6 Ohio St. 119.

tion or a corporation whose affairs are hopelessly involved are wound up and the property of such corporation is invested in a new corporation, the stock of which is usually "divided among such other parties interested in the old company as are parties to the reorganization plan."¹⁶ Space does not permit us to go into the details of the various plans and schemes of reorganization of corporations. However, it is to be said that it is a common practice for holders of bonds or mortgages to join in some plan of reorganization by foreclosure proceedings. Innumerable other plans and schemes might be suggested whereby reorganization of an insolvent corporation may be effected.

§ 102. Rights of dissenting stockholders.—We have heretofore suggested that a single non-assenting stockholder might prevent consolidation of a corporation in which he is interested. The principle of law invoked is, that as the charter constitutes a contract between the corporation and its stockholders, the stockholder cannot be compelled to give up his rights under this contract, and enter into another and different contract without his consent. Invoking this principle of law, the courts have repeatedly said that a stockholder may prevent consolidation by injunction, or if consolidation has been consummated and the stockholder is not guilty of laches, that the entire transaction might be set aside.¹⁷ There are, of course, exceptions to this general rule. In the first place, "the courts will require a very strong case for the granting of an injunction which will cause more injury than it will remedy, and it may be said, as a general rule, that an injunction

¹⁶ Bouvier's Law Dict.

¹⁷ Kohl v. Lilienthal, 81 Cal. 378, 20 Pac. 401; Market St. Ry. Co. v. Hellman, 109 Cal. 571, 42 Pac. 225; State v. Bailey, 16 Ind. 46, 79 Am. Dec. 405; Bott v. Simpsonville, etc. Co., 88 Ky. 54, 10 S. W. 134.

will not be granted where it will be productive of greater injury than will result from a refusal of it."¹⁸ In the second place, while it is the policy of equity in such cases to give to the dissenting stockholder at his election the fullest measure of compensation, that protection must be consistent with the rights of others and the general welfare of all of the stockholders.¹⁹ These cases would not apply to a reorganization.

§ 103. **Rights of creditors.**—The statutes of several states permitting the consolidation of corporations generally provide that the consolidating corporations shall be liable for all debts and obligations of the constituent corporations; that is, the consolidated corporation would be liable for the debts and obligations of the constituent corporations, up to the date of incorporation. Where such statutes exist, creditors of course may sue the consolidated corporation and recover the amount due from the constituent corporations.²⁰ Even in the absence of statutory provisions fixing the debts and obligations of the constituent corporations upon the consolidated corporation, it would seem that the debts of original companies fall as an incident of consolidation, and become, by implication, the obligations of the new corporation.²¹ It would seem upon principle, that the consolidated corporation should be liable and action-

¹⁸ 16 Am. & Eng. Enc. of Law (2nd Ed.) 363.

¹⁹ *Tanner v. Lindell Ry. Co.*, 180 Mo. 1, 79 S. W. 155, 103 Am. St. Rep. 534; *Belling v. Am. Tobacco Co.*, 72 N. J. Eq. 32, 65 Atl. 725; *Lauman v. Lebanon, etc. Ry. Co.*, 30 Pa. St. 42, 72 Am. Dec. 685; *International, etc. Ry. Co. v. Bremond*, 53 Tex. 96; *Ervin v. Oregon, etc. Co.*, 27 Fed. 625, 23 Blatchf. 517.

²⁰ *Berry v. Kan. City, etc. Co.*, 52 Kan. 759, 34 Pac. 805, 39 Am. St. Rep. 371; *Northern Central, etc. Co. v. Hering*, 93 Md. 164, 48 Atl. 461.

²¹ *Berry v. Kan. City, etc. Co.*, 52 Kan. 774, 36 Pac. 724, 39 Am. St. Rep. 381; *People v. Louisville, etc. Co.*, 120 Ill. 48, 10 N. E. 657; *Tennessee v. Whitworth*, 117 U. S. 139, 29 Law. Ed. 833.

able only for the debts and obligations of the old companies to the extent of the property received by it from such corporations; that is, where the debts exceed the value of the property, and the property is taken over from such insolvent corporation, the creditors should not receive from the new corporation pay in excess of the actual value of the property received by the new corporation;²² and it would seem, too, that the liabilities of the old company are not confined to debts arising out of contracts, but that the new corporation is chargeable for liabilities incurred by the consolidating corporations for tortious acts.²³ So, too, it has been held that the new corporation is chargeable for the performance of contracts entered into by the constituent corporations; that is, such contracts that they were bound to perform at the date of the consolidation.²⁴ Of course it need not be suggested that the consolidated corporation is only bound to perform to the same extent as the constituent corporation was bound at the date of consolidation.

In conclusion, it may be observed, that from what we already have said, consolidation as a method of uniting the business interests of different corporations is far from being satisfactory and practical. It would seem that the courts are unanimous in requiring corporations to comply fully with the law of consolidation. It will be found to be much easier, more practical, and conducive of better results to organize a new corporation

²² *Tompkins v. Augusta South. Ry. Co.*, 102 Ga. 436, 30 S. E. 992; *Morrison v. Am. Snuff Co.*, 79 Miss. 330, 30 South. 723, 89 Am. St. Rep. 598.

²³ *Texas, etc. Co. Ry. Co. v. Murphy*, 46 Tex. 360, 26 Am. Rep. 272; *Berry v. Kansas City, etc. Co.*, 52 Kan. 774, 36 Pac. 724, 39 Am. St. Rep. 381; *State v. Baltimore, etc. Co.*, 77 Md. 489, 26 Atl. 865.

²⁴ *U. P. Ry. Co. v. McAlpine*, 129 U. S. 305, 32 Law. Ed. 673; *Sappington v. Little Rock, etc. Ry. Co.*, 37 Ark. 23; *Boardman v. Lakeshore, etc. Ry. Co.*, 84 N. Y. 157.

and to transfer by sale all of the properties and rights of the old corporations direct to the new corporation, and to accept from such new corporation stock or bonds in proportion to the amount of property turned over. The courts seem to be more liberal in upholding sales of this character than consolidations, mergers, or amalgamations.

CHAPTER XV.

BY-LAWS.

- § 104. Definition and function.
- 105. Subject matter of by-laws.
- 106. Requisites of valid by-law provisions.
- 107. Making and adopting by-laws.
- 108. Enforcement of by-laws.
- 109. Binding effect on members.
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- 111. Amendment to by-laws.
- 112. Repeal of by-laws.

§ 104. Definition and function.—A by-law is a permanent and continuous rule for the government of the corporation, its directors and officers, and prescribing within the limit of the governing statute of the state under which the corporation is organized or operating, the powers and duties of such directors and officers.

The function of a by-law of a private corporation is to prescribe the rights and duties of the members with reference to the internal government of the corporation, the management of its affairs, and the rights and duties existing between the members *inter se*.¹

In addition to constituting a rule for the government of the corporation, and prescribing the powers and duties of its officers and directors, the by-laws should constitute a concise but complete plan, method and scheme of administering and carrying out the business transactions of the corporation and act as a safeguard about the corporate business.

They should be drawn for the protection of every stockholder with proper and necessary restraints upon

¹ Bornstein v. Dist. Grand Lodge, 2 Cal. App. 624, 84 Pac. 271; see also Lamb v. Merchants', etc. Co. (N. D.), 119 N. W. 1048.

the directors, and in some cases even upon the majority stockholders. They should go further than simply guiding the directors and officers to a lawful transaction of business, and should contain provisions requiring the directors and officers to follow scrupulously a rule of business honesty in all their transactions. By-laws are not designed to confer special rights or privileges upon any one, but to protect and preserve the rights and interests of all who are or may be interested in the corporation.

§ 105. **Subject matter of by-laws.**—As to what the by-laws should or should not contain, must under all circumstances be governed by the nature of the enterprise, the number of stockholders in the corporation, the scope of the business authorized under the charter, or expected to be carried out, and the conditions under which the corporation is operating or expecting to operate. In preparing a set of by-laws for the average corporation, care always should be exercised that the by-laws are prepared for that certain corporation, keeping ever in view its resources, the general nature and scope of its business, and, in fact, everything connected with the make up and operation of that particular corporation.

An error often indulged in is to follow some antiquated form of a corporation whose organization, make up and business are entirely different from the corporation adopting them. Indeed, often the by-laws intended for a mercantile corporation are adopted by a mining company. This is an error that should be avoided, as it encumbers the work of the company, and does not give the directors and officers an opportunity to manage it as it should be managed, without openly violating some provisions of the by-laws.

The statutory provisions of the state where the cor-

poration seeks to operate, relating to the management of the corporation, should be inserted in a brief and understandable way, so that the directors and officers can readily comply with all the provisions of the state law in their business transactions, by simply complying with their own by-laws. Many complicated questions and often serious litigation will thus be avoided.

We heretofore have said that by-laws should be drawn to protect the interests of all the stockholders. We do not mean by this to include provisions that will unnecessarily hamper the directors in the general management of the business affairs of the corporation. It should always be borne in mind that a corporation can best carry out the purposes for which it is organized, and can more safely promote the general plan of operation by having vested in the board of directors full and complete power, giving it a wide range of authority for all legitimate plans and operations. However, it is to be noted that provisions having for their object certain limits beyond which the majority of the stockholders cannot go will often protect the minority from fraud and imposition.

Of course the minority stockholders should always be protected against the wrongful acts of manipulating directors and even the wrongful acts of the majority stockholders. There is no escape from the proposition that so often has been referred to by the courts, that, constituted as humanity is, man always is ready to look to his own interests first. In these lax times, when every possible avenue of corruption is sure to find some desperate enough to enter; when on every hand we see duty sacrificed to interest; trust violated and business enterprise substituted for business honesty; when men are so easily led away from the path of duty by that powerful influence, self-interest, we are constrained to say that under all circumstances, except in *close corpo-*

rations, the by-laws should contain all necessary and proper restraints upon the directors, even to the risk of hampering them with some restrictions, for the stockholders always can be depended upon to release unnecessary restrictions, when properly called to their attention.

Under any and all circumstances the by-laws should contain at least general provisions as to the issuing and transferring of corporate stock; providing for lost certificates; for the time, place and manner of calling and holding meetings of the stockholders and directors, both regular and special, and the giving of notice thereof; the time and method of electing directors and officers and the filling of vacancies; prescribing in detail the qualifications, powers and duties of directors and officers; prescribing what number of shares shall constitute a quorum at stockholders' meetings, and what number of directors shall constitute a quorum at directors' meetings; prescribing powers and duties of all committees, special or otherwise; what bond, if any, shall be required of officers and who shall approve the same; what books of the company shall be kept and by whom and how and for what purpose; how the by-laws may be amended or repealed; how agents are to be appointed and their powers and duties. (Of course, we recommend a more comprehensive set of by-laws than the above outline would indicate.

§ 106. **Requisites of valid by-law provisions.**—The first necessary requisite to a valid by-law provision is that it shall not be contrary to law; that is to say, it shall not be contrary to the constitution or statutes of the state, nor the constitution and statutes of the United States; or contravene the common law, nor be against public policy or good morals.² Therefore, a by-law

² King v. Union, 170 Ill. 135, 48 N. E. 677; Peoples', etc. Bank v.

provision that is contrary to either the constitution or statutes of the state or the constitution and the statutes of the United States, or that contravenes the common law, or is against public policy or good morals, is absolutely void.³

The second requisite to a valid by-law provision is that it shall not conflict with the corporate charter. Therefore, should the by-law provision be contrary to or not in accord with the charter of the corporation, it will be void and of no force or effect.⁴ The third requisite is that the provision shall be reasonable.⁵ The reasonableness or unreasonableness of a by-law provision is a question of law as distinguished from a question of fact.⁶ The courts are universal in their holdings

Sup. Ct., 104 Cal. 649, 43 Am. St. Rep. 147; *Durkee v. People*, 155 Ill. 354, 46 Am. St. Rep. 340, 40 N. E. 626; *In re Election of Directors*, etc., 19 Wend. 37, 32 Am. Dec. 428; *Peoples' Bank v. Sadler*, 1 Cal. App. 189, 81 Pac. 1029; *Wells v. Black*, 117 Cal. 157, 48 Pac. 1090, 59 Am. St. Rep. 162; *People v. Chicago Live Stock Exch.*, 170 Ill. 556, 48 N. E. 1062, 62 Am. St. Rep. 404; *Trowbridge v. Hamilton*, 18 Wash. 686, 52 Pac. 328; *Ireland v. Globe, etc. Co.*, 21 R. I. 9, 41 Atl. 258, 79 Am. St. Rep. 769; *Victor G. Bloede v. Bloede*, 84 Md. 129, 57 Am. St. Rep. 373.

³ *Wells v. Black*, 117 Cal. 157, 59 Am. St. Rep. 162, 48 Pac. 1090, 37 L. R. A. 619; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 208; *Trowbridge v. Hamilton*, 18 Wash. 686, 52 Pac. 328; 5 Am. & Eng. Enc. of Law (2nd Ed.) 91; 10 Cyc. p. 355-6; *Kent v. Quick Silver Min. Co.*, 78 N. Y. 159.

⁴ *Peoples' Bank v. Chicago, etc. Exch.*, 170 Ill. 556, 62 Am. St. Rep. 404, 48 N. E. 1062, 39 L. R. A. 373; *Steiner v. Steiner Land Co.*, 120 Ala. 128, 26 South. 494; *Huston v. Reutlinger*, 91 Ky. 333, 34 Am. St. Rep. 225; *Peoples' Bank v. Sadler*, 1 Cal. App. 189, 81 Pac. 1029; *Presbyterian, etc. v. Allen*, 106 Ind. 593; *Ireland v. Globe Mill, etc. Co.*, 19 R. I. 180, 32 Atl. 921, 29 L. R. A. 429, 61 Am. St. Rep. 756 and note; 5 Am. & Eng. Enc. of Law, 95; *Boisot on By-laws*, § 38; 10 Cyc. 356.

⁵ *Peoples' Bank v. Sadler*, 1 Cal. App. 189, 81 Pac. 1029; *Bornstein v. District, etc.*, 2 Cal. App. 624, 84 Pac. 271; *Ex parte Frank*, 52 Cal. 606; *People v. Chicago Live Stock Exch.*, 170 Ill. 556, 48 N. E. 1062, 62 Am. St. Rep. 404, 39 L. R. A. 373; *Kent v. Quick Silver Min. Co.*, 78 N. Y. 159.

⁶ 10 Cyc. p. 358; 5 Am. & Eng. Enc. of Law (2nd Ed.) 99; *Bearden v. Peoples' Bldg. Ass'n*, 49 S. W. 64.

that for a by-law provision to be reasonable, it must apply to all members alike within the sphere of its operation. That is to say the provision must be definite and effective and operate equally and be of a general effect.⁷

A corporation can not by its by-laws disturb or impair vested rights⁸ even those which may have been created by the by-laws.⁹ This is true notwithstanding the fact that the power to alter, amend, or repeal its by-laws is given by the charter.¹⁰

Illustrations.

It has been held that a corporation can not enact a valid by-law provision requiring stockholders desiring to sell their stock to give a written notice to other stockholders, giving such stockholders the option to purchase at the price named, as such provision would be a restraint on alienation.¹¹ Where the provision of the by-laws requires that all differences of the stockholders must be settled by arbitration;¹² permitting shareholders to return their stock to the corporation at a fixed value;¹³ releasing stockholders from statutory liabilities;¹⁴ prohibiting a shareholder from instituting an action to dissolve the corporation; restricting the right to vote;¹⁵ providing that all transfers shall be subject

⁷ *Bearden v. People's Bldg. Ass'n*, 49 S. W. 64; *Budd v. Mult. S. Ry. Co.*, 15 Ore. 413, 15 Pac. 659, 3 Am. St. 169; *Balt., etc. Co. v. Powhatan Co.*, 89 Md. 59, 39 Atl. 274.

⁸ *People v. Chicago, etc. Exch.*, 170 Ill. 556, 62 Am. St. Rep. 404, 48 N. E. 1062, 39 L. R. A. 373; *Stillwell v. People's Bld.*, 19 Utah, 257.

⁹ *Savage v. Peoples' Bldg. Ass'n*, 31 S. E. 991.

¹⁰ *Holyoke v. Lewis*, 1 Colo. App. 126, 27 Pac. 872.

¹¹ *Victor G. Bloede Co. v. Bloede*, 84 Md. 129, 33 L. R. A. 107, 57 Am. St. Rep. 373, 34 Atl. 1129; *Ireland v. Globe Mill., etc. Co.*, 19 R. I. 180, 61 Am. St. Rep. 756, 32 Atl. 921, 29 L. R. A. 429.

¹² *State v. N. A., etc. Co.*, 31 South. 172, 87 Am. St. 309, 106 La. 621.

¹³ *Vercoutere v. Golden State, etc. Co.*, 116 Cal. 410, 48 Pac. 375.

¹⁴ *Wells v. Black*, 117 Cal. 157, 59 Am. St. Rep. 162, 48 Pac. 1090, 37 L. R. A. 619.

¹⁵ *People v. Troup*, 12 Wend. 183.

to the will and judgment of the board of directors;¹⁶ interfering with the free exercise or sale and transfer of stock;¹⁷ excluding directors or stockholders from examining the corporate books and records;¹⁸ authorizing the corporation to increase the liabilities of the stockholders for the debts of the corporation;¹⁹ compelling the stockholders to retire a part of their stock;²⁰ declaring a forfeiture of shares of stock for nonpayment of subscriptions;²¹ imposing excessive fines;²² have all been held to be invalid and not binding even upon the stockholders of the corporation.

So, too, the law is well settled that by-laws must be attached to the purposes of the corporation. That is to say, where the by-laws are wholly alien to the nature of the corporation, they are *ultra vires* and void.²³ A by-law provision in restraint of trade is void.²⁴ So, too, a by-law provision having a retroactive effect is a nullity. While the law is well settled that by-laws must be legal, reasonable within the charter limits and for the corporate purposes and are always strictly subordinate to the constitution and general law of the land, and cannot infringe on the policy of the state, nor be hostile to public welfare, nor restrict the freedom of

¹⁶ *Bank v. Wasson*, 48 Iowa, 336, 30 Am. Rep. 398.

¹⁷ *Moore v. Bank of Commerce*, 52 Mo. 377; *Victor G. Bloede Co. v. Bloede*, 84 Md. 129, 34 Atl. 1127, 33 L. R. A. 107, 57 Am. St. Rep. 373; *Ireland v. Globe Mill. Co.*, 21 R. I. 9, 41 Atl. 258, 79 Am. St. Rep. 769.

¹⁸ *People v. Troup*, 12 Wend. 183.

¹⁹ *Trustee, etc. v. Flint*, 13 Met. 539.

²⁰ *Bergman v. St. Paul, etc. Ass'n*, 29 Minn. 275, 13 N. W. 120.

²¹ *Budd v. Multnomah St. R. R. Co.*, 15 Ore. 413, 3 Am. St. Rep. 169, 15 Pac. 659.

²² *Lynn v. Freemansburg, etc.*, 117 Pa. St. 1, 11 Atl. 537, 2 Am. St. Rep. 639.

²³ *Matthews v. Associated Press*, 136 N. Y. 333, 32 N. E. 981, 32 Am. St. Rep. 741; *People v. Chicago, etc. Exch.*, 170 Ill. 556, 48 N. E. 1062, 62 Am. St. Rep. 404, 39 L. R. A. 373.

²⁴ *Am., etc. Co. v. Chicago, etc. Exch.*, 143 Ill. 210, 32 N. E. 274, 36 Am. St. Rep. 385, 18 L. R. A. 190.

trade or business, nor trammel competition, nor prohibit an individual from contracting and engaging in business, using such agencies and means as he may desire not contrary to law, the law is well settled that a corporation has power to enact by-laws for its government and guidance that will be binding upon all members and in some cases, upon persons dealing with the corporation. The courts are inclined to allow a wide degree of latitude to corporations passing in good faith by-law provisions for the government and guidance of its directors and officers.

Thus it has been held that a provision charging a small fee for transferring stock upon its books;²⁵ regulating the transfer or manner of transferring stock;²⁶ regulating the calling of corporate meetings;²⁷ fixing the time and place of holding corporate meetings;²⁸ prescribing the manner of voting at corporate meetings;²⁹ permitting the stockholders to be represented and their stock voted by proxy;³⁰ providing that a stockholder or executor desiring to sell his stock shall first offer the stock to the corporation;³¹ fixing the number necessary to constitute a quorum of directors;³² requiring officers and agents of the corporation to give bonds;³³ prescribing the method of filling vacancies of directors or officers;³⁴ providing for reason-

²⁵ *Gelsen v. London & N. W. Am., etc. Co.*, 102 Fed. 584.

²⁶ *Lockwood v. Mechanics' Natl. Bank*, 9 R. I. 308, 11 Am. Rep. 253; *Chandler v. Northern Cross R. Co.*, 18 Ill. 190.

²⁷ *Taylor v. Griswold*, 14 N. J. L. 222, 27 Am. Dec. 33; *Morrill v. Little Falls Mfg. Co.*, 53 Minn. 371, 55 N. W. 547.

²⁸ *Taylor v. Griswold*, 14 N. J. L. 222, 27 Am. Dec. 33.

²⁹ *State v. Tudor*, 5 Day, 329 (Conn.), 5 Am. Dec. 162.

³⁰ *People v. Crossley*, 69 Ill. 195.

³¹ *N. E. Trust Co. v. Abbott*, 163 Mass. 149.

³² *Hoyt v. Thompson*, 19 N. Y. 207.

³³ *Savings Bank v. Hunt*, 72 Mo. 597.

³⁴ *Kearney v. Andrews*, 10 N. J. Eq. 70.

able penalties;³⁵ creating a lien on the stock of a shareholder for debts due the corporation;³⁶ have all been held to be valid and legitimate provisions of the by-laws.

A charter provision that certificates of stock shall be assignable on the books of the corporation under such regulations as the board of directors shall establish, authorizes the by-law that, "no stockholder shall be permitted to transfer his stock of the company while he is in default."³⁷ In the construction of the by-laws they will be interpreted by the courts practically as interpreted by the corporation itself, provided, however, such interpretation is reasonable.³⁸

A by-law may be void in part and valid in part. That is, where there is an invalid provision in the by-laws, it does not necessarily invalidate the entire set.³⁹ A reasonable presumption will be indulged in favor of the validity of by-laws. The conclusion from the authorities is that by-laws must be reasonable and for a corporate purpose and always within charter limits. They must always be strictly subordinate to the constitution and general law of the land. They must not infringe the policy of the State nor be hostile to public welfare. They must not be *ex post facto* or retroactive.

They should contain no provision that tends in any manner to impair vested rights; nor should they contain any provision tending to violate the laws in restraint of trade; nor prohibit the sale or transfer of the corporate stock of members. They should in all cases be carefully and clearly drawn so that they will operate with equal rights to all the members of the corporation.

³⁵ *Graham v. House, etc. Ass'n*, 52 S. W. 1011.

³⁶ 10 Cyc. 360; *Boisot on By-laws*, § 61.

³⁷ *Cunningham v. Ala., etc. Co.*, 4 Ala. 652.

³⁸ *State ex rel. Atty. General v. Conklin*, 34 Wis. 21.

³⁹ 5 Am. & Eng. Enc. of Law, 103.

They should under no circumstances be extortionate, and should be drawn and enacted with the view of protecting alike under the law the rights and privileges of all the members of the corporation. Within these limits, courts are liberal in their views construing them.

§ 107. **Making and enacting by-laws.**—When a corporation is created there goes with it the power to enact by-laws for its government and guidance, as well as for the government and guidance of its members. This power is necessary to enable the corporation to carry out and accomplish the objects and purposes for which it was organized. Power to make and adopt by-laws for the government of its members and to regulate and define the purposes and duties of its directors and officers is an implied power. That is, a corporation has a right, as a matter of law, to make and adopt a code of by-laws for its government. All of the Pacific states now have statutes authorizing the stockholders to adopt by-laws for the government of the corporation. Indeed, the statutes of the states of California, Idaho and Montana require the corporation to adopt by-laws for the government of the corporation, not inconsistent with the constitution and laws of those states.

So, too, the law is settled to the effect that by-laws need not necessarily be in writing unless the statute of the state under which the corporation has been organized, or the charter of the corporation requires them to be in writing.⁴⁰

Notwithstanding this, however, the better plan is to have the by-laws drafted by a capable attorney and adopted by the stockholders of the corporation at a legal meeting and recorded among the permanent minutes thereof. No particular form is necessary, but it always is advisable that they be clear, concise and ar-

⁴⁰ State v. Silva, 130 Mo. 440, 32 S. W. 1007.

ranged with some system. In those states having statutory provisions regulating the adoption of by-laws, care always will be taken to see that their laws are carefully and fully complied with. In the states of California, Idaho, Montana and South Dakota the statutes not only require that the corporation shall make and adopt a code of by-laws for its government, but that they shall be adopted within a certain time after the filing of the articles of incorporation. Such statutes are regarded as directory, not mandatory.⁴¹

While the stockholders have an inherent power to adopt by-laws, this power may be in the absence of statutory prohibition delegated by such stockholders to the directors.⁴² California, Colorado, Utah and several other states have statutes authorizing the delegation of power to directors to make by-laws, while in Montana power to repeal or amend the by-laws may be delegated to the board of directors.

Where exclusive authority is vested in the directors to make and adopt by-laws for the government of the corporation, those adopted by the stockholders are not valid.⁴³

The by-laws must conform to the laws of the state wherein the corporation is organized.⁴⁴

It has been held that by-laws prepared and approved at a stockholders' meeting held before recording the Articles of Incorporation, if they are afterward relied on and treated as by-laws of the corporation by the directors and stockholders, must be regarded, in law, as the by-laws of the corporation.⁴⁵ On the other hand it

⁴¹ *Hall v. Crandall*, 29 Cal. 568; *Chapman v. Doray*, 89 Cal. 52, 26 Pac. 605.

⁴² *Heintaleman v. Druids Ass'n*, 38 Minn. 138, 36 N. W. 100; *Manufacturers', etc. Co. v. Landay*, 219 Ill. 168, 76 N. E. 146.

⁴³ *In re Klaus*, 67 Wis. 401, 29 N. W. 582.

⁴⁴ *In re Klaus*, 67 Wis. 401, 29 N. W. 582.

⁴⁵ *Graebner v. Post*, 119 Wis. 392, 96 N. W. 783, 100 Am. St. 890.

has been held that a copy of by-laws prepared and signed by the stockholders before organization is invalid.⁴⁶ Usually, however, they are adopted in a very haphazard and slipshod manner, at the organization meeting, sometimes without ever having been read. While this practice is not commendable, we can not see that it is very objectionable, for it must be admitted that adopting them by acquiescence at the organization meeting, in most cases would be sufficiently legal to bind the members of the corporation as well as all subsequent purchasers of stock.

In Montana, the assent of the stockholders representing a majority of all the subscribed stock, or a majority of the members, if there be no capital stock, is necessary to adopt by-laws. If they are adopted at a meeting called for that purpose, two weeks' notice of the same, by advertisement in some newspaper published in the county in which the principal place of business of the corporation is located. The written assent of the holders of two-thirds of the capital stock is sufficient to adopt the by-laws at the meeting held for that purpose. California and South Dakota both have very similar statutes to Montana. In Montana, Nevada, California, South Dakota and Idaho, the by-laws must be copied in a book known as "the book of by-laws" and no by-law takes effect until so copied. This book shall be open to the inspection of the public during office hours of each day except Sunday.

When the by-laws are adopted, they should be certified to by the secretary and the officer presiding at the meeting at which such by-laws were adopted, which certificate should show that they were adopted in conformity to the statute of the state and the charter of the corporation at a duly and regularly called meeting

⁴⁶ *Vercountere v. Golden State Land Co.*, 116 Cal. 410, 48 Pac. 375.

of the stockholders. "The power to make by-laws for the government of the corporate body, fixing and regulating its own duties and that of its members not inconsistent with its charter, or the purposes and objects of its creation, not repugnant to the common law, or to the laws of the state, constitutional and statutory, is an attribute of every corporation. The power is regarded as of so much importance that it is seldom left to implication, but is in express terms conferred by the law from which corporate existence is derived. When duly enacted by the body to whom the corporate legislative power is delegated, by-laws are binding upon all the members of the corporation, who are presumed to know them, and to contract in reference to them. It is the existing by-laws which are presumed to be known, and in reference to which it is presumed corporate contracts are made; as it is the existing municipal law of the place in which a contract is made, or is to be performed that parties are presumed to be conversant with and which incorporates itself into the contract, measuring their rights and duties. A corporation has not capacity, as the legislative power from which it derives existence has not competency, by laws of its own enactment, to disturb or divest rights which it had created, or to impair the obligation of its contracts, or to change its responsibilities to its members, or to draw them into new and distinct relations."⁴⁷

Generally speaking, it always is advisable to adopt by-laws of the corporation within the jurisdiction of the state under whose laws the corporation has been created. In some states it has been held that this is necessary.⁴⁸ However, it must be said in this connection that in those states where the statutes permit the stockholders and directors to hold their meeting outside of

⁴⁷ *Supreme Commandery Knights of Golden Rule v. Ainsworth*, 71 Ala. 436, 46 Am. Rep. 332.

⁴⁸ *Mitchell v. Vt. Copper Min. Co.*, 40 N. Y. Sup. Ct. 406.

the state of creation, the adoption of the by-laws at such meeting of the stockholders would be legal, not withstanding the meeting might be held outside of the jurisdiction of the state under whose laws the corporation was created. There is no question that the adoption of by-laws is a corporate act.⁴⁹

§ 108. **Enforcement of by-laws.**—Upon principle the law is well settled that the right of a corporation to enact by-laws carries with it the right to provide some method to secure their enforcement. The penalty often provided is a fine, suspension or expulsion. Of course such penalties must, under all circumstances, and in all cases be reasonable and not excessive, for where excessive fines are imposed by the by-laws upon the shareholders of the corporation, the courts will refuse to enforce them.⁵⁰

Notwithstanding the fact that the law authorizes the corporation to provide for fines as hereinbefore noted, we doubt very much the advisability of such provision in the by-laws. These provisions in by-laws have been the source of a large amount of litigation in corporations wherein they have been enacted and have been productive of practically no good results. Of course in benevolent, fraternal and insurance organizations, an exception exists, but in other corporations it will be found advisable to eliminate such a provision from the by-laws.

If there is anything that will destroy a corporation and waste the property of its stockholders, it is constant litigation over management matters. As a rule the average corporation is made up of a number of

⁴⁹ In re Klaus, 67 Wis. 401, 29 N. W. 582.

⁵⁰ Lynn v. Freemansburg, etc. Ass'n, 117 Pa. St. 1, 11 Atl. 537, 2 Am. St. 639; Graham v. House, etc. Co., 52 S. W. 1011; Vierling v. Mechanics', etc. Ass'n, 179 Ill. 524, 53 N. E. 979.

small stockholders, that is, stockholders holding a few shares of stock.

Often the property promoted must be developed. It depends upon the investing public to keep it alive and going. The first sight of litigation, or disturbance in the internal management of such a corporation operating under such circumstances, is sure to lessen its opportunities for securing funds to continue the promotion of the corporation and to cause unrest and dissension among the stockholders. This unrest and dissension will often lead to distrust, ill feeling, and dispute, endangering the success of the enterprise and the life of the corporation.

§ 109. **Binding effect on members.**—When duly enacted by the body to whom the corporate legislative power is delegated, by-laws are binding upon all members of the corporation who are presumed to know them and to contract in reference to them.⁵¹ The by-laws are not only binding on the members of the corporation, but they also are presumed to have knowledge as to the contents thereof.⁵²

§ 110. **Effect on third persons.**—By-laws being adopted to regulate the conduct and prescribe the rights and duties of the directors and officers of the corpora-

⁵¹ *Covenant Mutual Ben. Ass'n v. Spies*, 114 Ill. 463, 2 N. E. 482; *Jackson v. S. Omaha, etc.*, 49 Neb. 687, 68 N. W. 1051; *Kent v. Quick Silver Min. Co.*, 78 N. Y. 159; *Flint v. Pierce*, 99 Mass. 68, 96 Am. Dec. 691; *Columbia Bldg., etc. Ass'n v. Junquist*, 111 Fed. 645; *Farmers' Mutual Hall Ass'n v. Stattery*, 115 Iowa, 410; *Langnecker v. Grand Lodge, etc.*, 111 Wis. 279, 87 Am. St. Rep. 860, 87 N. W. 293; *Richardson v. Divine*, 193 Mass. 336, 7 L. R. A. 1076, 79 N. E. 77; *Wist v. Grand Lodge, etc.*, 22 Ore. 271, 29 Pac. 610, 29 Am. St. Rep. 603; *Purdy v. Bankers' Life Ass'n*, 101 Mo. App. 91, 71 S. W. 486; *Peoples', etc. Bank v. Sadler*, 1 Cal. App. 189, 81 Pac. 1029.

⁵² *Columbia Bldg., etc. v. Junquist*, 111 Fed. 645; *Brent v. The Bank of Wash.*, 10 Pet. (U. S.) 614, 9 Law. Ed. 547; *Arapahoe Cattle Co. v. Stevens*, 13 Colo. 534, 22 Pac. 823; 10 Cyc. 350; 5 Am. & Eng. Enc. of Law, 100.

tion, they will not be binding upon strangers contracting with the corporation, unless such strangers have actual notice of such by-law provisions.⁵³

§ 111. **Amendment to by-laws.**—Within reasonable limits and subject to the rules and conditions hereinbefore noted, a corporation has a clear right to amend or alter its by-laws. The by-laws themselves usually and in all cases should contain provisions as to their amendment or alteration. Generally speaking, the right to amend or alter the by-laws rests with the stockholders; however, it is believed that in the absence of statutory prohibition, this right may be delegated to the directors.

Montana and several other states have statutes authorizing the stockholders to delegate to the directors the power to amend, alter or repeal by-laws. This is a very doubtful delegation of power from the standpoint of corporate interests, as it has a tendency to put into the hands of directors too much power which could be used to the detriment of the stockholders, especially the minority. The most that should be allowed the directors in this regard is the power to adopt additional by-laws not inconsistent with those already adopted by the stockholders, for as has been suggested, if meritorious objections are pointed out to the stockholders, they always will be found ready and willing to eliminate them.

By-laws should be amended at the annual meeting of the stockholders. However, they of course may be amended at a special meeting called and held for that purpose. If the by-laws contain a provision as to the

⁵³ *Ashley Wire Co. v. Ill. Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187; *Pearsall v. Western Union Tel. Co.*, 124 N. Y. 256, 26 N. E. 534, 21 Am. St. Rep. 662; *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 38 Am. Rep. 330; but see *Commonwealth v. Vandegrift*, 81 Atl. 153.

manner of the amendment or alteration, then such provision must be complied with.⁵⁴ Amendments, like the provisions of the original of the by-laws must be legal, reasonable, not retroactive and attached to the purpose of the corporation. They can not interfere with nor abrogate vested rights of the stockholders, nor be contrary to the constitution or statute of the state, nor the common law, public policy or good morals.

Some states, among them Idaho, provide that the by-laws can be amended or repealed only at the annual meeting of the stockholders. In the absence of such statutes, they may be amended at any regularly called and held meeting.

§ 112. Repeal of by-laws.—The power to enact by-laws upon principle carries with it power and right to repeal them or any part thereof. This of course is subject to the rules hereinbefore stated particularly as to the proposition of the impairment of the rights of the stockholders.

Where a by-law of a corporation has been disregarded by the corporate officers for a length of time sufficient to bring knowledge thereof home to the stockholders and raise a presumption of the acquiescence, such nonusage will work an abrogation of such by-law.⁵⁵

⁵⁴ French v. O'Brien, 52 How. 394.

⁵⁵ Blair v. Metropolitan Sav. Bank, 27 Wash. 192, 67 Pac. 609.

CORPORATE MANAGEMENT

AND

BY-LAWS, FORMS AND CONSTRUCTION

We have already called attention to the fact that a by-law is a permanent rule for the government of the corporation, its directors and officers; that the function of a by-law is to prescribe the rights of the members with reference to the internal government of the corporation, the management of its affairs, and the rights and duties existing between the members.

It will therefore be noted that the by-laws should be so drawn as to furnish a complete guide to corporate officers and directors in the management of the company.

With this object in view we have prepared a complete and comprehensive set of by-laws, every section of which has been construed and interpreted by courts of last resort. Our object has been not only to furnish a permanent rule and guide, but to add the proper construction and interpretation of the various sections suggested.

From the following forms a code of by-laws, suitable for any corporation, may be prepared with very little effort.

STOCK.

Certificates of Stock. Every person who shall become a stockholder of the corporation, who has paid for his, or her, stock in full, shall be entitled to a certificate under the seal of the corporation, signed by the President or Vice-President and by the Secretary, certifying the total amount of capital stock authorized; the total number of shares, the par value and the number of shares contained in the certificate; also the class of stock, i. e., whether common or preferred, assessable or non-assesable. The certificate shall state the name of the person to whom issued and the date of its issuance, and shall be issued in consecutive or numerical order.

The stock certificate book shall contain a margin or stub on which shall be entered the number, date, number of shares and the name of the person expressed in the corresponding certificate.

Nearly all of the states now have statutes requiring the corporation to issue to the shareholder a certificate showing the number of shares to which he is entitled. These statutes vary greatly in the different states. The following states now have such statutes: California, Delaware, Georgia, Idaho, Indiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, South Dakota, Texas, Virginia and West Virginia. In Connecticut a corporation is prohibited from issuing certificates until the capital stock has been subscribed and paid for in full. In Iowa there must be endorsed on the face of the certificate what amount or portion of the par value has been paid to the corporation, and whether such payment has been in money or property. In Nevada there must be stamped or printed on the cer-

tificate the words "Treasury Stock" or "Promotion Stock," treasury stock being defined by the statute of that state as "stock that has been set aside in mining corporations, the proceeds of which are to be used for the development of the mining property of the corporation." All other stock is declared to be promotion stock.

The stock book of the corporation always should be a permanently bound book containing the certificates of stock, also a stub upon which shall be made a record of the corresponding certificate. That is, its number, the name of the holder thereof, the number of shares represented thereby, together with the date of its issuance. The stub of the stock book should also contain a short receipt to be signed by the recipient of the stock when the same is delivered to him. This stub always should be carefully filled out by the Secretary before the certificate is removed from the stock book.

Often the address of the stockholder will be noted on this stub. This, however, is unnecessary, as the corporation always should keep a book containing the names and addresses of its shareholders alphabetically arranged; in some states this is required. The original certificate never should be issued except on proper authority. Certificates of stock are regarded by the great weight of authority as being mere muniments of title, or evidence of ownership of the stock. It is to be noted, however, that the courts are showing a tendency in later days to regard them as more than such, and have adopted the rule that, for all business and practical purposes, certificates of stock are nothing more or less than the shares themselves. This is because of the fact that certificates of stock have come to be a common subject of barter and trade.

Certificates are handled, sold, paid for and delivered in the trade markets of the world every day; they pass

from purchaser to purchaser, through scores of hands, by simple endorsement in blank. Stock certificates, issued by a corporation having power to issue them, are a continuing affirmation of ownership of such amount of stock by the person designated therein, or his assignee, and the purchaser has a right to rely thereon. It will thus be seen that it is very important that the Secretary, or other qualified officer, shall properly care for the certificates of stock of the corporation and see to it that none of them get into circulation wrongfully or fraudulently. The stock book is usually kept by the Secretary.

Stock certificates are usually issued under the seal of the corporation, signed by the President, and countersigned by the Secretary; in some states, however, the statutes require the Treasurer to sign them instead of the Secretary. This is so in New Jersey. Where such statutory provisions exist, of course, it will be necessary that the by-laws provide that the Treasurer, instead of the Secretary, shall sign such certificates. Certificates should never be issued in blank, as this is a very loose and dangerous way of doing business, as well as being very questionable from many standpoints.

This is especially true when authority is given to some agent to write in the name and number of shares. It should never be permitted. When one has expended money upon the payment of official certificates of stock issued by a corporation, he has a right to be indemnified, to the extent of his expenditure against loss from false certificates. Not only is the corporation liable for all fraudulent issues of stock, but under certain circumstances, officers issuing certificates, regular on their face, are liable for the false and fraudulent statements contained thereon, and are liable for damages caused to innocent purchasers for value.¹

¹ *Windram v. French*, 151 Mass. 547, 24 N. E. 914, 8 L. R. A. 750.

Transfer of Stock. Shares in the corporation may be transferred at the principal place of business, within business hours, by the holder thereof, or by his attorney, duly and regularly constituted, or by his legal representative, by surrendering to the secretary of the corporation, the certificate representing the transferred stock, duly and regularly endorsed. No transfer shall be made nor new certificate issued until the certificate representing the transferred stock shall have been surrendered to the corporation, which certificate, when surrendered, shall be cancelled by the secretary and attached to the stub in the stock certificate book from which the same was originally detached.

All stock and transfer books shall be closed for transfers fifteen days before the annual meeting of the stockholders, and ten days before the dividend days. A transfer fee of fifty cents for each and every certificate issued representing transferred stock shall be charged, which amount shall be collected by the secretary prior to transferring said stock. Where the corporation is in doubt as to the genuineness of the signatures, or power of attorney, it shall be allowed a reasonable time to inquire into and ascertain whether or not the power of attorney, signature and ownership of the stock is genuine.

Every state, with the possible exception of California, Georgia, Massachusetts, Nebraska, Oklahoma, Tennessee and Utah, have express statutory provisions providing for the transfer of stock. Most of the states noted in the exception, have provisions in their general statutes that impliedly cover the transfer of stock. These statutes provide in substance that the shares of stock in every corporation shall be deemed personal property and transferrable on the books of the corporation in such manner and under such regulations as

the by-laws provide. Regardless of such statutes the holder of shares would be entitled to have them transferred on the books of the corporation and have issued to him new certificates. This is a right incident to the ownership of corporate shares.^{1a} The holder must, of course, submit to and comply with reasonable by-law requirements regarding the surrender of the old certificate properly endorsed, at the principal place of business of the corporation. He may also be required to pay a reasonable transfer fee.²

There is no question that the corporation has a right to provide reasonable rules and regulations governing the manner of transferring stock.³ Knotty and bothersome questions will often confront the secretary of a corporation regarding the transfer of corporate stock, some of which are more or less dangerous to his corporation. It should always be borne in mind that where there is more than one claimant to a certificate of stock, the secretary should recognize neither, but should properly protect his corporation with an action in court in the nature of a proceeding to determine who is the lawful and rightful owner of the corporate stock.⁴

The most common case that will arise for the consideration of the secretary is, where the stock has been attached or levied upon with a writ of execution, prior to the transfer on the books of the corporation, but after the certificate has been signed and delivered to the transferee. Under these circumstances the courts of a number of states have decided that the holder of a cer-

^{1a} See section 71, "Right to alienate and transfer stock" and cases there collected.

² *Geisen v. Loudow, etc. Co.*, 102 Fed. 584.

³ *Lockwood v. Merchants' Nat. Bank*, 9 R. I. 308, 11 Am. Rep. 253; *Miller v. Farmers', etc. Co. (Neb.)*, 110 N. W. 995; *Senn v. Union, etc. Co.*, 115 Mo. App. 685, 92 S. W. 507. See also statutes of the several states.

⁴ *In re Klaus*, 67 Wis. 401, 29 N. W. 582.

tificate, in good faith, will prevail over the judgment creditor in attachment, even though the transfer has not been made upon the corporate books prior to the levy.⁵ So that, unless the transfer is attacked for fraud, or upon the theory that it has been antedated, the corporation in such states is usually safe in making the transfer, and surrendering a new certificate to the transferee. However, should it afterwards transpire that the certificate was antedated, a very difficult question for the corporation arises; and where there are reasonable grounds of doubt, the safer plan is to settle the question with an order from the court as to the rightful ownership of the stock. On the other hand, the courts of many states⁶ hold that if an attachment is levied, or execution issued, prior to the transfer on the books of the corporation, then the corporation must recognize the attaching creditor. Where a corporation is in doubt as to the genuineness of the signatures, or power of attorney, it is allowed a reasonable time to ascertain, for its own satisfaction, and in most cases is, within reason, entitled to have some proof of the fact that the power of attorney, signature, and ownership of the stock are genuine.

This is so by reason of the fact that if the corporation transfers a certificate that has been stolen, or where the power of attorney has been forged,⁷ or even where the certificate has been signed by a *non compos mentis*, or infant, the corporation is liable;⁸ and the rightful owner can maintain an action for the recovery of the stock or the value thereof. As we have suggested, the owner or transferee of a certificate of stock has an ab-

⁵ New York, Pennsylvania, New Jersey, Michigan, Missouri, Delaware, Nebraska, Tennessee, Kentucky, Louisiana, Mississippi, Texas and Washington.

⁶ Arkansas, Alabama, California and Colorado.

⁷ Cook on Corporations (5th ed.), 367.

⁸ Chew v. Bank of Baltimore, 14 Md. 299; Smith v. Nashville, etc. Co., 91 Tenn. 221, 18 S. W. 546.

solite right, in law, to have such shares transferred upon the books of the corporation, where the certificate has been properly presented for transfer, and the person presenting the same offers, and is ready, to comply with reasonable by-law regulations. The corporation will be liable to such transferee for either the value of the stock on the date of refusal to transfer, upon the well settled rule that the refusal to transfer constitutes conversion of the shares, or the transferee may compel the corporation to recognize him, and make such transfer. Some courts hold that the transferee is entitled to a writ of *mandamus*. However, the weight of authority holds that *mandamus* will not lie, as there is an adequate remedy at law, namely, damages for conversion.

The actual transfer of stock is a very simple proceeding. A stock certificate when delivered by the corporation to the stockholder contains a blank form of assignment on the back thereof.

The shareholder when selling his stock will sign this form on the back, which signature is usually witnessed. The name of the person authorized to make the transfer is written in the blank space, which will usually be the secretary of the corporation. In this form it is presented at the office of the corporation, within business hours, and the old certificate is by the secretary cancelled, by stamping the word "cancelled" across its face, after which it is attached to the stub in the stock book from which it originally was detached. The new certificate is then written and turned over to the stockholder. The stockholder on receipt of the new certificate should sign the receipt on the stub of the stock book to which we have heretofore called attention.

Care should always be exercised, by the secretary, to see that the signature on the assignment corresponds exactly with the name on the face of the certificate. If

titles appear such as Doctor, Professor, Judge, Trustee, Executor, etc., on the face of the certificate, they should also appear on the assignment. If the stock stands in the name of an executor or an administrator, the corporation is usually safe in permitting the transfer by requiring the executor, or administrator, to file with the corporation a certified copy of the letters of administration.⁹

A corporation is charged with the duty of trustee toward its stockholders for many purposes, and must therefore exercise due care and diligence to protect the title of the *cestui que trust*, or beneficial owner, and is answerable for any injury sustained by him through its negligence or misconduct. Therefore, if the corporation has knowledge, or information that the transfer is made for the purpose of, in some manner, defrauding the estate, it is bound to refuse to transfer such stock, otherwise it will be liable for such transfer. Where the stock stands in the name of a trustee, it is sufficient notice to the corporation that the stock is held in trust.¹⁰ The corporation, in such cases, is required to ascertain from the instrument creating the trust whether or not the trustee has a right to sell or transfer the stock, and in the absence of such showing, which must be clear, the corporation should refuse to transfer.

Where the stock stands in the name of the guardian, it is sufficient notice to the corporation of the guardianship, and while it may not be necessary in every case, it is the better and safer practice to require an order of court before permitting such stock to be transferred.¹¹ This protects alike the guardian and the corporation. Often a very serious question will arise where stock stands in the name of an infant, as an in-

⁹ *Caulkins v. Gas-light Co.*, 85 Tenn. 683, 4 Am. St. Rep. 786.

¹⁰ *Shaw v. Spencer*, 100 Mass. 382, 1 Am. St. 115.

¹¹ *Webb & Graniteville Mfg. Co.*, 11 S. C. 396, 32 Am. Rep. 479.

fant's sale of stock is not binding upon him. That is, he may at his option disaffirm it on reaching his majority, so that the corporation should never be satisfied with the signature of an infant, but should require such legal steps as are proper to protect the corporation before making the transfer. We venture the suggestion that a corporation, under no circumstances, should permit stock to be issued and stand on its books in the name of an infant, as it is always dangerous to the interests of the corporation.

In cases of lunatics, of course, the corporation should always see to it that their stock is lawfully endorsed, and should under all circumstances refuse to content itself with the signature of such lunatic, regardless of the date thereof. It will sometimes happen that the signature on the certificate owned by a lunatic will appear of some date prior to his lunacy. This should not satisfy the corporation.

The secretary will of course, in all cases except lost certificates, require the surrender of the old certificate before issuing the new one. To do otherwise, he is liable to involve the corporation in litigation for, as we have heretofore suggested, by reason of the fact that stock certificates duly and regularly issued by the corporation are a continuing affirmation of ownership of such amount of stock by the person designated therein, or his assigns, a purchaser has a right to rely thereon. While a purchaser of such certificates could not require a transfer, he could recover damages from the corporation.¹² Transfer of stock by a corporation upon its books, in the absence of the original certificate, is made at its peril, and the real owner of the stock, evidenced by such certificate, loses nothing thereby.¹³

¹² C., N. O. & T. P. Ry. Co. v. Citizens' Nat. Bank, 56 Ohio St. 351, 47 N. E. 249, 43 L. R. A. 777.

¹³ Deeme v. Buffalo, etc. Van., 11 Barb. (N. Y.) 580.

Often certificates of stock will be assigned with the name of the transferee left in blank, and in this manner pass from hand to hand, through scores of purchasers and finally reach the purchaser who desires to become a registered stockholder on the books of the corporation. He will then write in his name on the blank space in the assignment, as transferee, and present the same to the corporation for transfer. If the secretary is in doubt as to the ownership, he may require some reasonable proof of such ownership.¹⁴

Lost Certificates. The board of directors may cause to be issued a new certificate of stock in the place of the certificate theretofore issued but alleged to have been lost, or destroyed. Before such new certificate shall be issued, however, the owner of such lost, or destroyed certificate, or certificates, shall be required to give the corporation a bond in such sum not less than the par value of the stock, nor more than double the par value of such stock, as may be directed by the board of directors, as indemnity against any claim that may be made against such corporation. The board of directors may refuse to issue such new certificate until ordered by a court of competent jurisdiction.

The above by-law provision is a substantial copy from the statutes of New Jersey. California, Connecticut, Delaware, Maryland, Massachusetts, Minnesota, Nevada, New Mexico, New York, North Carolina, Ohio, Vermont, Virginia, and West Virginia have similar statutory provisions. Many of these statutes provide that should the board of directors refuse to issue a new certificate of stock in place of one alleged to have been lost, or destroyed, the owner of such lost or destroyed certificate may apply to the court in which the princi-

¹⁴ *Liscomb v. Condon*, 56 W. Va. 416, 49 S. E. 392, 107 Am. St. Rep. 938.

pal office of the corporation is located, for an order on the corporation to show cause why it should not be required to issue a new certificate of stock in place of the one so lost or destroyed.

Outside of these statutory provisions there is no law requiring the corporation to issue new certificates to shareholders who have lost or destroyed their old ones, yet certificates of stock are often lost, destroyed, or stolen, and it is only fair and right to the stockholders that such a provision be enacted. In New York the statute undertakes to remedy this difficulty by the issuance of a duplicate certificate. Such are, to say the least, somewhat doubtful from every standpoint. The stockholder, as a matter of fact, suffers no loss from the loss of his certificate, except as a matter of convenience. He is a stockholder of the corporation just the same, and is entitled to the same rights and privileges of a stockholder, both in being represented at meetings, voting his stock, and drawing dividends. However, if he wishes to sell or dispose of the stock, or pledge the same as security, he would probably experience some difficulty, unless he could produce his certificate. Therefore, we suggest the above, or a similar provision as a fair and equitable remedy to both the corporation and the shareholder.

Of course, care always should be taken to see to it that the bond required is properly drawn, executed and filed with sufficient securities. When a certificate is lost or stolen, notice should be given the secretary immediately, and after receiving such notice the secretary will refuse to transfer the certificate as no person, not even an innocent purchaser, has a superior right to the certificate than the person who lost it.¹⁵

¹⁵ *East Birmingham Land Co. v. Dennis*, 85 Ala. 565, 7 Am. St. Rep. 73, 2 L. R. A. 836, 5 South. 317; *Barstow v. Savage Min. Co.*, 64 Cal. 388, 49 Am. Rep. 705.

The corporation will of course continue to recognize such person as a stockholder with every right and privilege as such. The fact that he has lost his certificate makes no difference. The amount of the bond as suggested in this by-law provision is believed to be fair and just to both the corporation and the shareholder.

Treasury Stock. All stock that shall have been issued and delivered to the owners thereof by the corporation, which may thereafter be donated to or purchased by the corporation, shall be designated as treasury stock. The board of directors shall have full control of all treasury stock of the company with the right to sell and dispose of the same below par for such price, on such terms, and at such times as they may determine. Such stock shall be entitled neither to vote at corporation meetings nor participate in dividends, so long as it is held by the company.

It is to be noted at the outset that there is a broad distinction between non-issued stock and treasury stock.

The by-law provision above quoted is given as advisable for the reason that the usual practice in the organization of a corporation is to eliminate the subscription to the capital stock prior to the organization and usually prior to the organization meeting. The corporation is organized, and at the organization meeting property will usually be transferred to the corporation, and the entire capital stock be issued in payment thereof, with the understanding that a certain part of this same stock will be donated to the treasury of the corporation. This stock is then called treasury stock, and like any other property of the corporation should be placed at the disposition of the board of directors.

The purpose in creating treasury stock is that the corporation may have a fund, or capital with which to develop the mine, or business. While the statutes of

most states do not cover treasury stock, the statutes of Nevada definitely define it in connection with mining corporations, where it is to be sold for money, or other valuable consideration, the proceeds of which are to be used for actual improvement or development of the property owned by the corporation. Again, this method is pursued for the purpose of paying up the capital stock of the corporation and permitting the directors to sell the company's stock below par, without having liability for the debts of the corporation attached thereto. It is to be noted, however, that it is doubtful whether this transaction will relieve a stockholder from the actual statutory liability for unpaid stock, if the property has been purchased at a fictitious price, or overvaluation.¹⁶

Of course treasury stock until it is sold and has passed into the hands of stockholders cannot vote or participate in dividends declared by the corporation, as it is in this respect nothing more nor less than corporate property. This stock, in some states, has been held to be subject to taxation. The statutes of a very few states of the commonwealth recognize treasury stock. Treasury stock being an asset of the corporation, it cannot be voted or sold to the directors or the officers of the corporation, not even for a valuable consideration.¹⁷ And where treasury stock has been voted to directors, it may be cancelled by dissenting stockholders.¹⁸ Unissued stock is, of course, stock that has never been issued by the corporation.

¹⁶ *Campbell v. McPhee*, 36 Wash. 593, 79 Pac. 206; *Davies v. Ball*, 116 Pac. 833.

¹⁷ *Mosher v. Sinnott*, 20 Colo. App. 454, 79 Pac. 742.

¹⁸ *Mosher v. Sinnott*, *supra*.

STOCKHOLDERS.

Annual Meeting. The annual meeting of the stockholders shall be held at the principal place of business of the corporation at two o'clock P. M. on the second Monday in June of each year for the election of a board of directors and for the transaction of any other business that may properly come before such stockholders' meeting.

The stockholders are the real power of the corporation. Of course the business transactions of the company will be managed, conducted and carried on by their agents and trustees, yet all things are indirectly in their hands. The directors are always elected, or should be, at the annual meeting of the stockholders.

This meeting must be held in the state of the creation of the corporation, unless express statutory permission is granted to hold such meeting outside of the jurisdiction of such state. This seems to have been the common-law rule. Of course where the statute of the state wherein the corporation is organized permits such meeting to be held outside of the state, then such meeting will be valid and binding, otherwise it will be null and void.

It would seem that the states of Alabama, Michigan, Minnesota, Nevada, Pennsylvania, and West Virginia have such statutes. Care should be taken to hold the stockholders' meeting within the state of incorporation, unless express permission to hold such meeting elsewhere is given by the statute of the state. As the corporation faculty cannot accompany the natural persons beyond the bounds of the sovereignty which confers it, and they cannot possess or exercise it there, they can have no more power there to make the artificial being act than other persons not named or associated as incorporators. Any attempt to exercise such a faculty there is merely an usurpation of authority by persons desti-

tute of it and acting without any legal capacity to act in that manner.¹⁹

The annual stockholders' meeting should usually be held at the principal place of business of the corporation. In Montana, Idaho, New Jersey, Washington and a few other states, this is necessary. We have suggested elsewhere that the stockholders are the real power of the corporation. This is so only when acting in the capacity of stockholders and in a duly and regularly called and held meeting.

Stockholders acting in their individual capacity can neither bind the corporation nor have a voice in its affairs, although they may own a majority of its stock.²⁰ Thus the importance of the annual meeting of the stockholders where the stockholders have an opportunity to meet and determine who shall be the directors of the corporation for the ensuing year, will be readily understood. Under such a by-law provision as is above given, no notice would be necessary to the calling of the stockholders' meeting, as the time and place is fixed in this provision, unless of course the by-laws elsewhere contain provisions requiring notice to be given and prescribing the method of giving such notice.²¹

While the principal purpose of calling this meeting is to elect the directors for the ensuing year, it should not be confined to this particular purpose, but the stockholders at such meeting should learn the ins and outs of their corporation. They should insist on full reports being made by all the officers, especially the president, general manager and treasurer; they should

¹⁹ *Miller v. Ewer*, 27 Me. 509, 46 Am. Dec. 619.

²⁰ *Hill v. Atl. etc. Co.*, 143 N. C. 539, 55 S. E. 854; *Leibhart v. Wilson*, 31 Colo. 1, 88 Pac. 173; *National Hollow Brake Beam Co. v. Chicago, etc. Co.*, 226 Ill. 28, 80 N. E. 556; *Lawson v. Black Diamond C. Min. Co.*, 44 Wash. 26, 86 Pac. 1120.

²¹ *Morrill v. Little Falls*, 53 Minn. 371, 21 L. R. A. 174, 55 N. W. 547; *People v. Beck*, 11 Wend. (N. Y.) 604, 27 Am. Dec. 104.

know the general plan of operating, past and future. If the by-laws are to be amended they should be amended at this meeting with full knowledge of their contents. In preparing for the annual meeting, the officers who will have charge will always have the same well and carefully planned.

An alphabetical list of the stockholders should be prepared immediately upon closing the stock transfer books;²² the proxies filed will be carefully added up so that unnecessary time is not lost at the meeting. In fact preparations for the annual stockholders' meeting will be started immediately upon closing the stock and transfer books of the company. It is usually the duty of the secretary to publish the required notice for the calling of this meeting, and where he fails in this duty, he may be required to call such meeting by a writ of *mandamus*. The majority of stockholders will of course control in this meeting, which is their legal right. The exercise of this lawful right seldom will be interfered with by the courts.

Special Meetings. Special meetings of the stockholders may be called and held by the shareholders of the corporation at any time at the principal place of business of the corporation for the determination of any question pertaining to the corporation or its business affairs. Such meetings may be called by the board of directors, and it shall be

²² The statutes of New Jersey require the secretary, or other officer, designated by the board of directors having charge of the books, to make a full, true and complete list, in alphabetical order, of all the stockholders entitled to vote at the ensuing election, with the residence of each. This list to be made at least ten days before every election after the first election. The list to be at all times in the principal and registered office, and open to the inspection and examination, during the usual business hours, of any stockholder. The statutes of Delaware and New Mexico closely follow those of New Jersey.

their duty to call such meeting at the written request of the stockholders owning and holding at least one-third of the outstanding stock. The call for such meetings shall clearly specify the time, place and object, or objects thereof, and it shall not be lawful to transact business not specified in such call and notice.

Special meetings of the stockholders will often be found necessary to authorize the board of directors to do some act beyond their power as directors; such as selling the entire assets of the corporation; amending the charter; consolidating or merging with other corporations; dissolving and winding up the affairs of the corporation, or to do some act that the stockholders alone can do, such as expelling an untrustworthy director.

The first necessary requisite to a valid special meeting is that the call be issued by proper authority, second, that the notice shall contain a statement of the business to be transacted; also the date, the hour, and the place of holding the meeting; and third, the notice must be lawfully and properly served upon each and every stockholder. The meeting must then be held in accordance with this notice and at the time and place therein fixed. The business transacted will of course be in strict accordance with the purpose set forth in the notice, as any attempt to do anything not contained in the notice will be a nullity.

Where the by-laws or charter provide for calling and holding a special meeting and the officers fail, neglect or refuse to call and hold such a meeting, they may be required to do so with a writ of *mandamus*. It will be observed that failure to comply with any of the four suggestions above given will invalidate the entire proceedings, unless all of the stockholders of the corporation meet at such meeting and take part therein.

Therefore, great care always must be exercised in calling and holding a special meeting of any kind, especially where business of an extraordinary nature is to be transacted.

Notice of Meetings. All regular and special meetings of the stockholders shall be called by notices printed in one or more newspapers of general circulation published at the principal place of business of the corporation as the directors may direct, for at least fifteen days next preceding the date of such meeting.

If there be no newspaper published at the principal place of business of the corporation then such notice shall be published in the newspaper nearest thereto. In all special meetings such notice shall state the time, place, object or objects of such meeting or meetings. In case of the regular annual meeting of the shareholders, no irregularity in the call or notice thereof shall invalidate such meeting or the proceedings had thereat.

There can be no question that all shareholders are entitled to notice of the time and place of holding any and all corporate meetings. This notice must be given as required by the by-laws of the corporation.²³ No particular form of notice is necessary unless prescribed by the statute, charter, or by-laws. All that is necessary is that the notice shall be intelligible and advise the stockholders of the time and place of holding such meeting. Where the stockholders attend and vote in the annual stockholders' meeting, they cannot, thereafter, question the validity of such meeting on account of some irregularity in the notice, or failure to give such notice. In other words the meeting is binding on all the stockholders who meet and participate in such

²³ In re Hammond, 139 Fed. 898; Wall v. Utah Copper Co., 70 N. J. Eq. 17, 62 Atl. 533.

meeting.²⁴ Where the stockholders sign waivers of notice in the call, no notice is necessary to the holding of a valid meeting.²⁵ If the statute, charter and by-laws are silent as to the method of giving notice to the shareholders, then personal notice in all cases would seem to be required.²⁶ So, too, if the statute, charter or by-laws are silent as to the length of time given in such notice before the holding of the meeting, then the time must be reasonable so as to give the shareholders an opportunity to attend.²⁷

Unless such notice is given a stockholder of the meeting as indicated, the acts and things done at the meeting, in so far as that particular stockholder is concerned, will be void.²⁸ Invalid acts, however, which are made so by some irregularity of the call or notice of the meeting or proceedings had thereat, may be made valid by subsequent ratification if all the stockholders are present and ratify such acts.²⁹ Where a stockholder attends and participates in the proceedings of a meeting, he will not afterwards be heard to complain that the required notice was not served on some other stockholders,³⁰ and where a person receives the benefit of the meeting he will not be permitted to complain.³¹

Quorum. No meeting of the stockholders shall be competent to transact business unless a majority of

²⁴ *Hiles v. Hiles & Co.*, 120 Ill. App. 617.

²⁵ *Gray v. Bloomington & N. R. Co.*, 120 Ill. App. 159; *Bridgeport v. Meader*, 72 Fed. 115; *Campbell v. Argenta Co.*, 51 Fed. 1, construing Montana statute regarding sale of property.

²⁶ *Lockwood v. Mechanics' Nat. Bank*, 9 R. I. 308, 11 Am. Rep. 253.

²⁷ *In re Long Island, etc. Co.*, 19 Wend. (N. Y.) 37, 32 Am. Dec. 429.

²⁸ *Barthell v. Hencke*, 99 Wis. 660, 75 N. W. 952.

²⁹ *Stutz v. Handley*, 41 Fed. 531.

³⁰ *Schenectady, etc. Co. v. Thatcher*, 11 N. Y. 103

³¹ *Handley v. Stutz*, 139 U. S. 417.

the shares of stock issued and outstanding shall be present, except to adjourn from day to day, or until such time as they may deem proper. Where a majority of the shares issued and outstanding are present at any corporate meeting called and held as herein provided, a vote of the majority of the shares represented shall decide any question or matter properly brought before such meeting.

As to what number of shares is necessary to constitute a legal quorum where each share is entitled to one vote may be fixed either by the governing statute, the charter, or by-laws of the corporation. Where the statute, charter, and by-laws are silent upon this question, the rule is that a majority of the issued and outstanding shares is necessary to constitute a quorum. The treasury stock of the corporation will always be excluded from the count, as well as unissued stock. The usual provision is that a majority of the outstanding stock is necessary to constitute a legal quorum, although it must be admitted that in the absence of statutory or charter regulation the by-laws may fix the number at less than a majority of such outstanding stock. However, this is never advisable. If a quorum is not present, the meeting may adjourn from time to time until a quorum can be secured. Where the by-laws provide that a full majority of the stockholders or shares of stock are necessary for a certain purpose, they will be construed as meaning a full majority of the stock outstanding, whether represented in the meeting or not.³²

The secretary should always ascertain by means of a roll call if there is a quorum present. This should always be done before the transaction of any business

³² *In re Argus, etc. Co.*, 1 N. D. 434, 26 Am. St. Rep. 639, 48 N. W. 347, 12 L. R. A. 781.

of any kind. It is now often provided in the charter, or by-laws, that a certain per cent of the capital stock is necessary to make any radical changes in the corporate affairs, such as mortgaging its property, amending its by-laws, suspending a director, etc. The per cent is usually fixed at two-thirds or three-fourths.

Such provisions are now generally regarded as advisable especially for the protection of the minority stockholders. The corporation has a right to fix, in its by-laws, in the absence of statutory restrictions, the number of shares necessary to constitute a quorum for the transaction of the corporate business.

Proxies. Stockholders may be represented at all meetings, regular or special, by proxy. The authority of such proxy shall be in writing, signed by the stockholder and filed with the secretary not less than fifteen days next preceding the date of the meeting.

A person appointed to represent a stockholder, at corporate meetings, is called a proxy. This term is also applied to the instrument appointing such person. When used in this sense, a proxy is but another name for a short and concise form of power of attorney, and is usually governed by the same rules and laws as govern powers of attorney. They are now regarded as a very important part of the corporate machinery. Often important corporate meetings will be held with but very few persons in attendance, personally, while the will of hundreds of shareholders will be expressed and carried out with proxies.

Authority to permit stockholders to be represented in this way at a corporate meeting must be found either in the governing statute, the charter, or by-laws of the

corporation as it is denied at common law.³³ However, statutory authority now exists in nearly every state giving shareholders the right to be represented in corporate meetings by proxy. Many of these statutes place a time limit on proxies. Thus in California, no proxy shall be valid after the expiration of eleven months from the date of its execution, unless the stockholder executing it shall have specified therein the length of time for which said proxy is to continue in force, which must be for some limited period, and in no case to exceed seven years from the date of the execution of such proxy. In Maine proxies must be executed within thirty days before the meeting, in Massachusetts within six months, in Minnesota, one year, New York, eleven months, and New Jersey, three years.

Where the right is given by the governing statutes, charter, or by-laws, it is generally regarded as sufficient, and the shareholders cannot be denied the right.³⁴ The holder and owner of the corporate stock will be bound by the vote of the person holding a proxy, regardless of whether or not such representative voted such stock in his interest or against his interest.³⁵

Where the holder of stock is represented by proxy he cannot complain of any irregularity of the call, or the time, or the place of holding the meeting, if his representative was present and voted at such meeting.³⁶ It is to be noted, however, that care should always be

³³ *Commonwealth v. Bringhurst*, 103 Pa. St. 134, 49 Am. Rep. 119; *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 54 Am. St. Rep. 749, 24 S. E. 489; *McKee v. Home, etc. Co.*, 122 Iowa, 731, 98 N. W. 609.

³⁴ *People's Home, etc. Bank v. Sup. Court*, 104 Cal. 649, 38 Pac. 452, 43 Am. St. Rep. 147; *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 24 S. E. 489, 54 Am. St. Rep. 749.

³⁵ *Lafferty's Estate*, 154 Pa. St. 430, 26 Atl. 388.

³⁶ *Bank v. Matthews*, 85 Fed. 934. Compare *Matthews v. Bank*, 79 Fed. 558.

taken to see that the holder of the power of attorney, or proxy, does not exceed the power granted in such power of attorney. Thus, where the proxy or power of attorney simply gives the holder thereof the right to vote for directors, his powers are confined to voting for directors, and he cannot bind the stockholder in any other matter or thing that might come before the meeting. It has been held that power to vote upon the increase of stock does not give the holder the right to vote upon the question of disposing of such increase of stock.

The corporation has an unquestionable right to prescribe reasonable rules as to the date of filing the proxy with the secretary of the company. An executor, administrator, or trustee can execute a lawful proxy, if executed in his official capacity.³⁷

Proxies may be revoked at any time. It must not be forgotten that a proxy holder is nothing more or less than an agent of the stockholder. His powers exist only at the will of his principal and may be revoked by such principal at any time. It is wholly immaterial whether the holder of a proxy is engaged for a definite time or not, as an agency and contract of hiring are entirely distinct.³⁸

Usually the appearance of the owner of the stock and his voting at the meeting will, *ipso facto*, revoke any outstanding proxies. They may be revoked in writing, or even orally.³⁹ Irrevocable proxies are looked upon with more or less disfavor by the courts as being opposed to public policy, and they will be set aside upon very slight showing, unless coupled with an interest,

³⁷ Schmidt v. Mitchell, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427.

³⁸ Schmidt v. Mitchell, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427.

³⁹ Schmidt v. Mitchell, *supra*.

or based upon good and valuable consideration in good faith, even though there is nothing fraudulent in the transaction.⁴⁰

Where, however, the giving of the proxy for a certain period of time is coupled with an interest, or based on a good and valid consideration in good faith, and the transaction is free from fraud, and not designed for the purpose of carrying out some unlawful scheme, the proxy is undoubtedly valid and cannot be revoked until the expiration of the time therein named.⁴¹ However, any attempt on the part of the holder of the power of attorney or proxy to betray his trust may be prevented by an injunction.

Voting trusts are now a very common occurrence and have often been upheld by the courts. However, it is to be noted that pooling agreements of any kind are looked upon with more or less suspicion by the courts, and in every case it must be clear that it is not a scheme or device for the purpose of carrying out some unlawful plan in the restraint of trade, nor against public policy, or public morals, and free from fraud and wrong doing to the stockholders, and further that it is based upon good and valuable consideration. Otherwise the courts will not hesitate to hold them illegal.⁴²

Voting. Only stockholders of record on the books of the corporation, or their duly constituted proxies, shall be entitled to participate, or vote, in corporate meetings. All elections shall be by ballot, and every stockholder shall have the right to cast one vote, in person, or by proxy, for each share of

⁴⁰ *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 24 S. E. 489, 54 Am. St. Rep. 749.

⁴¹ *Mobile v. Ohio R. R. Co.*, 98 Ala. 92.

⁴² *Smith v. San Francisco Co.*, 115 Cal. 584, 47 Pac. 582, 35 L. R. A. 309, 56 Am. St. Rep. 119; *Faulds v. Yates*, 57 Ill. 416, 11 Am. Rep. 24; *Kreisel v. Distilling Co.*, 61 N. J. Eq. 5, 47 Atl. 471.

stock owned by him, and standing in his name on such books.

This provision taken from the statute of Montana should be in the by-laws of every corporation. The statutes of nearly every state allow stockholders to be represented by proxies of their selection. Under these statutes a by-law providing that no proxy shall be voted by any one not a stockholder of the corporation, is void, as being an infringement upon the statute.⁴³ A by-law cannot take away, or even abridge, the substantial rights of a stockholder. Under the common law each stockholder had one vote, regardless of the number of shares owned by him. This is still permitted by express statutory provision of several of the states.

Thus, in Washington a corporation, by its by-laws, may limit each shareholder to a single vote, or one vote for every full share of paid-up stock, or its equivalent in assessable stock, disregarding the number of shares of stock he may own.⁴⁴ Under this statute the exception must affirmatively appear in the by-laws.⁴⁵

However, nearly every state in the Union has statutory provisions, providing that each stockholder, either in person or by proxy, shall be entitled to as many votes as he may own shares of stock in the corporation. In the absence of some statutory, charter or by-law restriction each and every stockholder has a right to vote at all stockholders' meetings. The power to vote is inherently annexed to and inseparable from each share of stock.⁴⁶

⁴³ *People's Home Sav. Bank v. Sup. Court*, 104 Cal. 649, 38 Pac. 452, 43 Am. St. Rep. 147.

⁴⁴ *Rem. & Bal. sec. 3686.*

⁴⁵ *State ex rel. Mitchell v. Horan*, 22 Wash. 197, 60 Pac. 135.

⁴⁶ *Smith v. Burns Boiler & Mfg. Co.*, 132 Wis. 177, 111 N. W. 1123; *Harvey v. Linville Imp. Co.*, 118 N. C. 693, 24 S. E. 489, 54 Am. St. Rep. 749; *Lucas v. Milliken*, 139 Fed. 816; *Commonwealth v. Dalzell*, 152 Pa. St. 217, 25 Atl. 535, 34 Am. St. Rep. 640; *Taylor v. S. P. Co.*,

Notwithstanding that the right to vote is incident to the ownership of stock, a corporation under such a by-law provision as is here recommended is not required to recognize any person as a stockholder unless he is such on the books of the corporation.⁴⁷

The Supreme Court of Vermont has held that a provision in the charter excluding non-resident stockholders from voting was valid and might be enforced.⁴⁸ The supreme courts of both Maryland and Alabama have held that there might also be a limit as to the number of votes cast by any one person.⁴⁹ These provisions cannot be evaded by transferring the stock to other persons. To us it seems that these decisions from Maryland and Alabama are anything but good law, and contrary to the spirit of corporate organization. The majority of stockholders have no power to deprive any stockholder of his right to vote, not even in stockholders' meetings.⁵⁰

Although a stockholder may have an interest in the subject matter of the transaction to be voted upon, he is not for this reason barred from voting.⁵¹

Pledges of stock, who are such of record on the books of the corporation in the absence of the statute to the

122 Fed. 147. Compare: *Smith v. San Francisco, etc. Ry. Co.*, 115 Cal. 584, 47 Pac. 582, 56 Am. St. Rep. 119.

⁴⁷ *Brewster v. Hartley*, 37 Cal. 15, 99 Am. Dec. 237; *Haskell v. Read*, 93 N. W. 997; *State v. Pettinell*, 10 Nev. 141; *In re Argus, etc. Co.*, 1 N. D. 434, 48 N. W. 347, 26 Am. St. Rep. 639, 12 L. R. A. 781.

⁴⁸ *State v. Hunton*, 28 Vt. 594.

⁴⁹ *Mack v. Debardeleben C. & I. Co.*, 90 Ala. 396, 8 South. 150, 9 L. R. A. 650; *Campbell v. Poultney*, 6 Gill & J. (Md.) 94, 26 Am. Dec. 559.

⁵⁰ *Smith v. Burns Boiler & Mfg. Co.*, 132 Wis. 177, 111 N. W. 1123; *Durkee v. People*, 155 Ill. 354, 40 N. E. 626, 46 Am. St. Rep. 340; *People's Home Sav. Bank v. Sup. Court*, 104 Cal. 649, 38 Pac. 452, 43 Am. St. Rep. 147.

⁵¹ *Windmueller v. Standard Dist. Co.*, 115 Fed. 748.

contrary are entitled to vote such stock.⁵² So, too, where stock appears on the books of the corporation in the name of a trustee, or executor, such trustee or executor will usually be entitled to vote such shares.⁵³ The statutes of New Jersey, Idaho, Montana, Nevada, Massachusetts, Indiana, Connecticut and several other states provide in substance that every person holding stock as executor, administrator, guardian, or trustee, or in any other representative, or fiduciary capacity, may represent the same at all meetings of the corporation and vote thereon as a stockholder.

By reason of the fact that a corporation cannot be a stockholder in itself, it cannot vote its treasury or unissued stock.⁵⁴ Where stock is held by several trustees or executors it must be voted jointly.⁵⁵

Where the by-laws prescribe the method of voting as is here suggested this method should be followed by the corporation. However, it is generally believed that all provisions of this character are directory and not mandatory, and that a substantial compliance with their provisions is all that is required by the law. This is especially true where no objections are made at the time the vote is cast. Cumulative voting is where a stockholder is entitled to as many votes as are equal to the number of his shares of stock multiplied by the number of directors to be elected.

He may cast all these votes for a single director or may distribute them among the whole number as he desires. This method of voting insures a representa-

⁵² *Hoppin v. Buffum*, 9 R. I. 513, 11 Am. Rep. 291; *Commonwealth v. Dalzell*, 152 Pa. St. 217, 34 Am. St. Rep. 640; *Miller v. Murray*, 17 Colo. 408, 30 Pac. 46.

⁵³ *Commonwealth v. Dalzell*, 152 Pa. St. 217, 34 Am. St. Rep. 640; *Hoppin v. Buffum*, 9 R. I. 513, 11 Am. Rep. 291.

⁵⁴ *Am. Ry. Frog Co. v. Haven*, 101 Mass. 398, 3 Am. Rep. 377.

⁵⁵ *Schmidt v. Mitchell*, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427.

tive of the minority on the board, if the votes are properly cast. It is one of the strongest safeguards that the minority stockholders have. Such voting, however, is illegal unless permitted by statute.⁵⁶

California, Colorado, Idaho, Iowa, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, New Jersey, New York, North Dakota, Pennsylvania, South Carolina and West Virginia permit cumulative voting either by statute or constitutional provisions.

In Montana the statute provides that "all elections must be by ballot, and every stockholder shall have the right to vote in person or by proxy the number of shares standing in his name, as provided in Section 3840 of this Code, for as many persons as there are directors to be elected, or to cumulate said shares and give one candidate as many votes as the number of directors multiplied by the number of his shares of stock shall equal, or to distribute them on the same principle among as many candidates as he shall think fit. In corporations having no capital stock each member of the corporation may cast as many votes for one director as there are directors to be elected, or may distribute the same among any or all of the candidates. In either case the directors receiving the highest number of votes shall be declared elected."⁵⁷

Most of the states, however, provide that cumulative voting may be provided for in the by-laws of the corporation, or articles of incorporation. It is believed to be the better practice to provide for cumulative voting in the charter as well as in the by-laws, provided of course that the corporation is organized under the laws

⁵⁶ *State v. Stockley*, 45 Ohio St. 304, 13 N. E. 279; *State v. Greer*, 78 Mo. 188.

⁵⁷ Political Code, sec. 3835.

of a state permitting such voting. Otherwise as we have already suggested it should not be undertaken.

Directors, Election of. There shall be elected from among the stockholders, each year, at the annual stockholders' meeting a Board of Directors, of such number as is fixed in the articles of the corporation. The directors so elected shall serve for one year and until their successors are elected and qualified.(a)

Classification. The directors shall be classified with respect to the time for which they shall severally hold office by dividing them into three classes, each consisting of one-third of the whole number of the board of directors. The directors of the first class shall be elected for a term of one year; the directors of the second class shall be elected for a term of two years, and the directors of the third class shall be elected for a term of three years, and at each annual election, the successors to the class of directors whose term shall expire shall be elected for a term of three years, so that a term of office of each class of directors shall expire in each year.(b)

In case of an increase of the number of directors the additional directors shall be elected in the same manner as is provided herein for the election of directors, and one-third of their number for the unexpired portion of the term of the directors of the second class and one-third of the number for the unexpired portion of the term for the third class, so that each class of directors shall be increased equally.

The election of directors is the most important act the stockholders, as such, have the privilege of per-

(a) Where the directors are classified this section of the by-laws must be omitted, as it would be inconsistent with the section marked(b).

forming. By the very nature of corporate organization the management and control of its affairs must be intrusted to agents, called directors. They are selected at the annual meeting of the stockholders and by virtue of their selection take charge and control of the business affairs of the corporation. In this age of "pooling agreements" and "voting trusts" so regularly used by the controlling interests of the great industrial corporations, called trusts, the stockholders' meeting has been resolved into a sort of a ratification meeting.

If this by-law provision, that is, the classification provision, is used, it will be necessary to alter somewhat the entire section of the by-laws, as it will be noted that the provision for the election of directors provides that the directors shall be elected for one year. This should be changed to correspond with the classification clause. There is no question that this method has merit. It furnishes a board of directors for the corporation that will always be familiar with the business affairs and transactions of the company, and with the interests of the corporation at large.

In corporations having an extensive business and a large number of stockholders, we believe classification as suggested is advisable. Usually the number of directors is named and fixed in the articles of incorporation; and, as we heretofore pointed out, where this is a fact, it is necessary to amend the articles of incorporation in order to secure a change of that number. However, in some states, Arizona, New Jersey and Washington among them, the maximum number will be given in the articles of incorporation, and the exact number is left for the by-laws.

Where permitted by statute, this is advisable for it has the merit of permitting a change in the number of

directors by simply amending the by-laws instead of the articles of incorporation. This may be done at the annual meeting of the stockholders, with no expense to the corporation. The directors should qualify immediately after election by taking the usual oath of office, as their consent to act is necessary. It has been held in this regard that where a person is ignorant of the fact that he was elected, or elected without notice and does not qualify, he is not an officer of the corporation.⁵⁸ However, if he assumes his duties and acts as a director that will be sufficient, and he is at least, in that case, a *de facto* officer.⁵⁹

Resignation. The resignations of directors shall be in writing filed with the secretary. No resignation shall take effect until it shall have been acted upon and accepted by the board of directors.

The purpose of the above by-law provision is to prevent directors escaping the duties imposed upon them, for they have been elected and consented to act in the capacity of a director until they have been released by some official act.

As a general proposition, the director of a corporation may resign at will if the charter, statutes or by-laws impose no limitation. Under the rule of law generally announced it is not necessary that his resignation be accepted. When the director tenders his resignation or files it with the secretary of the corporation, to take effect immediately, his resignation is complete, even though the corporation may never act upon or accept such resignation.⁶⁰

Where the resignation of a director is actuated by

⁵⁸ *Rosecrans Gold Min. Co. v. Morey*, 111 Cal. 114, 43 Pac. 535.

⁵⁹ *Blake v. Bayley*, 82 Mass. 531.

⁶⁰ *International Bank v. Faber*, 86 Fed. 443; *Manhattan Co. v. Kaldenburg*, 165 N. Y. 1, 58 N. E. 790.

ulterior motives, the mere filing of his resignation with the secretary may not release him.⁶¹

Inspectors. At each annual meeting where directors are to be elected, there shall be appointed, by the presiding officer of such meeting, two inspectors of election, who shall take an oath to faithfully, impartially and to the best of their ability, perform and discharge their duties. It shall be their duty to receive and pass upon the validity of all proxies; pass upon and decide all questions concerning the qualification of voters; to receive and count the votes and certify to the returns.

No candidate for election as director shall be appointed as an inspector.

This by-law provision is self-explanatory. It simply provides inspectors whose duty it shall be to open and close the voting; receive and count the ballots and certify to the result. Of course, incident to this duty is the determination of all questions concerning the legality and validity of the votes offered at the meeting. The appointment of these inspectors will always be found advisable, as their work often expedites the work of the stockholders' meeting, especially where there is a large number of stockholders. The presiding officer in appointing this committee should see to it that persons not connected with the management of the corporation are appointed. In New York, the statute provides that inspectors of the election, two in number, shall be elected at each annual meeting of the stockholders to conduct the election of the directors for the ensuing year. This is believed to be the only state requiring inspectors to be elected.

⁶¹ *Zeltner v. Zeltner Brew. Co.*, 174 N. Y. 247, 66 N. E. 810, 95 Am. St. Rep. 574; *Evarts v. Killingworth*, 20 Conn. 447.

Order of Business. The order of business at the annual stockholders' meeting shall be as follows:— First, proof of notice; second, roll call; third, reading and acting upon minutes of previous meetings; fourth, report of officers and committees; fifth, the election of directors; sixth, miscellaneous business.

All corporations should provide in the by-laws an order of business for their annual meeting, and in most cases even for special meetings. This will insure an orderly and harmonious meeting and business conducted in a systematic and expeditious manner. The order of business here proposed is believed to be in harmony with the logical conduct of the business. As the law requires due and proper notice to the shareholders, the first order of business should be proof of notice of the meeting as provided by the by-laws.

This proof should always be submitted by the person designated by the by-laws to give the notice, which proof should always be recorded in the minutes of the meeting. It is usually a simple and plain written statement, signed by the secretary of the corporation, to the effect that the call and notice has been published in some newspaper, naming it, as the by-laws require, and giving a copy of the call and published notice. The next logical order, if not the necessary order, is to determine if there be a quorum present, and, if there is not, then, as we have seen, no business can be transacted. Hence the second order of business should be the roll call.

It is to be noted here that unless due notice has been given according to the by-laws, the meeting cannot be called to order, even for the purpose of adjournment, while if there is not a quorum present, but due and proper notice has been given, the meeting can then be called to order and adjournment taken to some certain

date. The next order of business should be reading and acting upon the minutes of previous meetings. This always is advisable, as it amounts, in some cases, to a ratification on the part of those stockholders who were not present at a former meeting, but present and voting for the approval thereof.

The fourth order of business should be the reports of officers and committees. This is necessary to properly advise the stockholders of the condition of the corporation, giving them an opportunity to act intelligently on the affairs of the corporation. Having been advised by the reports of the officers and committees how the corporation has been conducted and the progress that it has made, condition of its financial affairs and, in fact, everything pertaining to its business, the stockholders will then be ready to exercise the most important right vested in them, and that is, the right to participate in the election of the directors, which we propose as the fifth order of business.

The balance of the business to be transacted, unless a special meeting is in session, is more or less perfunctory. Unfinished business, new business and adjournment will usually follow in their respective order. A copy of the order of business should always be furnished to the presiding officer by the secretary, and he should always see that it is carefully followed, otherwise the meeting will soon be lost in confusion, which always leads to useless, unnecessary discussion among the stockholders. This always should be avoided. If there is any dissatisfaction reference should be had to committees and disputes among the stockholders settled in this way.

If a new corporation needs anything in the world, it needs the assistance, co-operation and good will of its stockholders. If there is anything that will assist a corporation in establishing a successful and perma-

nent business, it is the support of its stockholders. Many a promising corporation has been wrecked by dissatisfaction and strife among the stockholders and managing officers of the corporation. Therefore, the officers in charge of this meeting, which is the all important meeting of the corporation, should see to it that a spirit of good feeling, confidence and co-operation exists throughout the entire meeting, and the stockholders leave the meeting with the feeling that their interests are in hands that will properly protect and care for them at all times, and that the welfare of the corporation will be protected carefully, legitimately and vigorously.

Directors, Qualification of. No person shall be elected as director of the company unless he is the owner of one or more shares of stock in his own name and right on the books of the corporation at the time of his election.*

Whenever any director shall sell or dispose of all of his shares of stock in the corporation, such act shall, *ipso facto*, vacate such office and he shall no longer act as such.

The stockholders of a corporation have an unquestioned right to prescribe such qualifications, within reason, as they think right and proper for the directors, and not possessing the qualifications named in the by-laws, he is ineligible for election. The requirement that he be a stockholder on the books of the corporation is a reasonable and valid one.⁶² Indeed the statutes now generally, and the by-laws always should provide, that before a person is eligible to be elected a director of the corporation, he must be a stockholder. While it has

* NOTE.—Under the laws of Delaware a director must own at least three shares of stock.

⁶² In re Argus Prtg. Co., 1 N. D. 435, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639.

been held that where a person is ineligible by reason of not being able to comply with the by-law requirements of the corporation, he cannot even be a *de facto* director⁶³ yet, the corporation will not be permitted to take any advantage if it has held him out as a director and persons have relied thereon.⁶⁴

Where the statute requires the directors of a corporation to be stockholders therein, a director by the sale of all his stock, *ipso facto*, ceases to be a director.⁶⁵ It has also been held that an assignee of stock who appears as a stockholder on the corporate books is qualified to vote the stock and hold the office of director, although the transfer was made to him for the sole purpose of qualifying him.⁶⁶ Usually an executor or trustee holding stock on the books of the corporation as such, will fill the stock requirement.⁶⁷ Provisions requiring a person to be a resident of the state and making a bankrupt ineligible have been upheld.⁶⁸

The number of directors to manage the affairs of the corporation is usually fixed in the articles of incorporation, and when so fixed the better practice is not to repeat the number in the by-laws. Often the number will be decreased or increased by amending the articles of incorporation, in which event, if the number is stated in the by-laws, it would necessitate amending the by-laws also. Of course, when permitted by statute, and the articles do not fix the number, but provide that the

⁶³ Schmidt v. Mitchell, 101 Ky. 570, 41 S. W. 929, 72 Am. St. Rep. 427; Rosecrans Mining Co. v. Morey, 111 Cal. 114, 43 Pac. 585.

⁶⁴ Kuser v. Wright, 52 N. J. Eq. 825, 31 Atl. 397.

⁶⁵ Oudin & Bergman, etc. Co. v. Conlan, 34 Wash. 216, 75 Pac. 802; Clark & Marshall on Corporations, sec. 661; 10 Cyc. 738; Orr Water Ditch Co. v. Reno Water Co., 17 Nev. 166, 30 Pac. 695.

⁶⁶ In re Argus Printing Co., 1 N. D. 435, 48 N. W. 347, 12 L. R. A. 781, 26 Am. St. Rep. 639.

⁶⁷ In re Argus Printing Co., *supra*.

⁶⁸ Chem. Nat. Bank v. Colwell, 132 N. Y. 250, 30 N. E. 644; Schmidt v. Mitchell, *supra*.

number be fixed by the by-laws, then it is absolutely necessary that the number be fixed as above stated. This is now regarded as the better practice when permitted by the statute of the state wherein the corporation is organized. In the absence of statutory, charter or by-law regulation, the stockholders have a right to elect any person they choose as director. Other qualifications than those named in the by-law provision, suggested here, might be named if the stockholders think it advisable. This matter, within reason, is within their sound discretion.

Powers. The corporate powers, business, property and interests of this corporation shall be exercised, conducted and controlled by the board of directors, who shall have power to conduct, manage and control its business and affairs, and to make rules and regulations not inconsistent with the laws of the state, or these by-laws; to appoint and remove, at pleasure, all officers, agents and employees, prescribing their duties and fixing their compensation; to call special meetings of the stockholders when they deem it necessary; to incur indebtedness, the terms and amount of which shall be entered on the minutes of the board, and the note or obligation given for the same, signed officially by the president and secretary, shall be binding on the corporation.

It shall be the duty of directors to cause to be kept a complete record of all minutes and acts, and of the proceedings of the stockholders, and to present a full statement at the regular annual meeting of the stockholders showing, in detail, the assets and liabilities of the corporation, and generally the condition of its affairs. A similar statement shall be presented at any other meeting of the stockholders, when required by persons holding at least one-third of the capital stock of the corporation; to declare dividends out of the

surplus profits, when such profits shall, in the opinion of the directors, warrant the same; to supervise all officers, agents, and their employees and see that their duties are properly performed. They shall have power to do all things necessary to carry out the objects and purposes for which the corporation is organized.

The above by-law provision, while somewhat elaborate, is but a substantial declaration of the general powers vested in the directors under well recognized legal principles. Corporations are now universally managed by a board of directors.⁶⁹ The directors must depend either upon the statutes of the state, the charter, or the by-laws for their powers.⁷⁰

The statutes now generally provide in substance, that the corporate powers, business, and property of all corporations must be exercised, conducted, and controlled by a board of directors, to be elected from among the stockholders. Nearly every state has a statute upon this question.

As to the number of directors, in Arizona there is no statutory requirement, nor is there any resident qualification; in California the statute provides for not less than three; in Colorado not less than three, nor more than thirteen; in Connecticut, three or more; in Delaware, not less than three; Florida, not less than three nor more than thirteen; Idaho, not less than three, nor more than fifteen; Illinois, not less than five, nor more than eleven; Indiana, not more than thirteen; Kansas, not less than three, nor more than twenty-four; Kentucky, not less than three; Maine, not less than three; Maryland, not less than three; Massachusetts, not less than three; Missouri, not less than three; Montana, not less than three, nor more than fifteen; Nevada, not less

⁶⁹ *Kidd v. N. H. Traction Co.*, 74 N. H. 160, 66 Atl. 127.

⁷⁰ *Van Hattan v. Modern Brotherhood* (Iowa), 108 N. W. 313.

than three; New Mexico, not less than three; South Dakota, not less than three, nor more than eleven; New York, not less than three; North Dakota, not less than three, nor more than eleven; Oklahoma, not less than three nor more than eleven; Utah, not less than three, nor more than twenty-five; Washington, not less than two.

Where the charter or by-laws grant to directors certain special powers, there follows therefrom certain implied power, that is, power to do all things necessary to carry into effect the special powers as granted.⁷¹ Within the scope of their powers, the acts and judgments of the board of directors are supreme and binding upon the corporation, and the courts will not generally interfere with the management of the corporation by its directors.⁷²

Directors are at all times amenable to such restrictions as are prescribed by the statute, charter and by-laws, and they are further confined to the management of the regular business of the corporation.⁷³ Thus directors will not be permitted to sell or dispose of the corporate assets for their own use and benefit.⁷⁴ They have no right to give away any of the assets, or manipulate the stock of the corporation for the purpose of securing control of such corporation.⁷⁵ Being trustees, in the full sense of the term, they are required to act, at all times, with the utmost good faith toward all the stockholders, and manage and conduct the affairs of the corporation for the interests of their *cestui que trust*.

⁷¹ In re Beaver Knitting Mills, 154 Fed. 320.

⁷² Figge v. Bergenthal, 130 Wis. 594, 109 N. W. 581.

⁷³ Chicago, etc. Co. v. Allerton, 18 Wall. (U. S.) 233, 21 L. Ed. 902.

⁷⁴ McIver v. Young Hdw. Co., 144 N. C. 478, 57 S. E. 169; Haines Ming. Co. v. Hyland Gold Mines Co., 49 Ore. 71, 88 Pac. 865.

⁷⁵ Elliott v. Baker, 194 Mass. 518, 80 N. E. 450.

While the powers of the board of directors are greater in some states than in others, generally speaking, the power and authority of a director to bind his corporation is very extensive. Unless special restrictions are made in the governing statutes, charter or by-laws, they have the power to borrow money, execute notes and other evidences of indebtedness.⁷⁶ They may also sell and convey property necessary to meet the outstanding debts of the corporation, and sell and assign notes in the usual course of business.⁷⁷

It has been held that they may make an assignment for the benefit of creditors, when such assignment is absolutely necessary.⁷⁸ So too, the board of directors have the right to compromise and settle claims,⁷⁹ and make short time leases on the corporate property.⁸⁰ On the other hand, the law is well settled that there are certain acts beyond the power of the board of directors, unless express permission is given either by the governing statute, or charter, and in some cases in the by-laws, and the board has no authority outside of the general conduct of the business of the corporation. In the absence of special charter or statutory permission, the board of directors has no authority or power to increase or decrease the capital stock of the corporation.⁸¹

⁷⁶ *Saltmarsh v. Spaulding*, 147 Mass. 224, 17 N. E. 316; *Blood v. La Serena Land & W. Co.*, 113 Cal. 221, 41 Pac. 1017, 45 Pac. 252.

⁷⁷ *Bank v. Bank*, 92 U. S. 122, 23 L. Ed. 679.

⁷⁸ *Calumet P. Co. v. Haskell, etc. Co.*, 144 Mo. 331, 45 S. W. 1115, 66 Am. St. Rep. 425; *Chase v. Tuttle*, 55 Conn. 455, 12 Atl. 874, 3 Am. St. Rep. 64; *Vanderpool v. Gorman*, 140 N. Y. 563, 35 N. E. 932, 24 L. R. A. 548, 37 Am. St. Rep. 601.

⁷⁹ *Bank v. Bank*, 92 U. S. 122, 23 L. Ed. 679.

⁸⁰ *Beveridge v. N. Y., etc. Co.*, 112 N. Y. 1, 19 N. E. 489, 2 L. R. A. 648.

⁸¹ *Chicago, etc. Co. v. Allerton*, 18 Wall. (U. S.) 233, 21 L. Ed. 902; *Eidman v. Bowman*, 58 Ill. 444, 11 Am. Rep. 90; *Nashua, etc. v. Boston*, 27 Fed. 821.

Neither can the board amend the articles of incorporation;⁸² nor has it authority, generally speaking, to consolidate, reorganize or merge with other corporations;⁸³ nor to dissolve the corporation; nor wind up the corporate affairs;⁸⁴ nor sell and dispose of the entire property and assets of the corporation;⁸⁵ nor release subscribers to its capital stock;⁸⁶ nor make, alter, or repeal the by-laws.⁸⁷

DUTIES AND LIABILITIES.

It is not our intention to discuss with any degree of completeness the various liabilities fixed by law upon the directors and trustees of a corporation, but we shall confine ourselves to a few general, practical suggestions for the proper guidance of the board. We have heretofore noted that the directors of the corporation stand in a fiduciary relation to the corporation and its stockholders.⁸⁸ This relation requires of them the utmost good faith in all their transactions and prevents them from in any manner acquiring an interest adverse to their trust. This relation also imposes upon them certain duties, which will be discussed more fully hereinafter.

Aside from the liabilities fixed by statute, they are, of course, liable for frauds and deceit practiced upon the general investing public. Thus where directors are guilty of sending out circulars, prospectuses and reports containing false and fraudulent statements concerning the property of the corporation, knowing such

⁸² Eldman v. Bowman, *supra*.

⁸³ State v. Steele, 37 Minn. 427.

⁸⁴ Jones v. Bank, 10 Colo. 464, 17 Pac. 272.

⁸⁵ See subject, "Sale of Corporate Property."

⁸⁶ Guthright v. Oil City Land, etc. Co., 41 Fed. 54.

⁸⁷ Morton Gravel Road Co. v. Wysong, 51 Ind. 12.

⁸⁸ Livermore, etc. Co. v. Riley et al., 78 Atl. (Me.) 980; Hinkley v. Oil & Pipe Line Co., 132 Iowa, 396, 107 N. W. 629, 119 Am. St. Rep. 564; Hill v. Gould, 129 Mo. 106, 30 S. W. 181.

reports, circulars and prospectuses to contain false and fraudulent statements, they are liable to all who purchase stock relying upon such statements on well settled principles of law.

Thus, where false and fraudulent circulars, reports and prospectuses are circulated by directors, knowing them to be false, and such false and fraudulent reports induce a person to purchase stock, such person would have a cause of action against such directors either for damages sustained, or for a rescission of the contract of purchase.⁸⁹ Such action can only be maintained by persons damaged, or misled by the false and fraudulent statements. Directors are also liable for *ultra vires* acts, that is, acts beyond the powers of the corporation. For such acts stockholders may maintain an action; either to prevent the contemplated, or attempted act by injunction, or for rescission if the act has already been carried into effect. The rule of law invoked is: "That he has invested his means upon an agreement with his fellow corporators that they shall be devoted to the promotion of the general objects defined in the charter," and any attempt to carry out or do any act not permitted by such charter is a violation of his rights, for which the courts will grant prompt redress.

Thus, the directors should always be familiar with the powers granted by the charter. They should be familiar also with the statutes of the state under which the corporation is organized and familiarize themselves with the corporate by-laws.

It should be laid down as an unvarying rule that the directors should never transgress or violate these by-laws, nor exceed the powers granted in their charter, nor undertake to carry such powers into effect, except according to the provisions of the charter and the by-

⁸⁹ *Rohrschneider v. Knickerbocker, etc. Co.*, 76 N. Y. 216, 32 Am. Rep. 290.

laws, for a single dissenting stockholder is permitted under certain circumstances to plunge the corporation in litigation and involve the individual directors in serious liabilities.

We repeat here what we have tried to impress throughout this entire work, that the directors under all circumstances should strive to keep the corporation from being involved in litigation and strife. Many a promising enterprise has been wrecked, and valuable property rights have been lost to stockholders and investors, by needless and unnecessary litigation.

The most prevalent class of directors' frauds and abuses, and for which strict accounting will be required in all cases, are the wrongful acts practiced directly upon the corporation itself by the directors. These frauds and abuses are quite numerous, and partake of innumerable schemes, manipulations and devices, all of which should receive condemnation by all fair minded people.

Among such frauds and abuses practiced by directors is the voting of exorbitant salaries, to themselves, or immediate friends and business associates; voting and donating to themselves large blocks of capital stock. This often partakes of a series of manipulations, beginning with the organization of the corporation; voting large and unreasonable salaries to the officers of the corporation; speculating with the corporate property; securing profits and benefits to themselves in contracts and sales; refusing to prosecute just and legal suits, to properly protect the corporate interests; purchasing treasury or other stock of the corporation without the consent of the stockholders; organizing, or taking part in, other corporations, having for their purpose, the making of contracts and dealing with the original company. All such forms of fraud and deceit have been from time to time condemned with much vigor by the courts.

Thus, if they are treacherous to its interests and appropriate its property, or intentionally waste its assets, or take money for official acts, or "sell out" by resigning and thus giving control to others, they are liable to account in equity to the corporation, or its representatives, not only for the money or property in their hands, but also for such as they fraudulently dispose of or waste, as well as for the damages naturally resulting from their official misconduct, and even, as we have recently said, for money received by virtue of their office.

Where the president and directors of a corporation receive money for the transfer of the control of the corporation to other parties, it is no defense that such action was for the purpose of reimbursing themselves and other directors for monies which they have invested in promissory notes issued by the corporation, when such notes were not legally collectible from it.⁹⁰ Where the directors issue to themselves or to any one of their number, treasury stock of the corporation, such stock may either be cancelled, or they may be liable for the same. This is so, notwithstanding the fact that the corporation may have received some consideration for such stock.⁹¹

Many other specific instances and forms of wrong might be enumerated, but enough is here given to illustrate and point out to the directors the general scope of their liabilities for fraudulent acts practiced directly upon the corporation itself. Of course, the stockholders of the corporation can maintain an action against the directors and protect the property interests of the corporation. Where some of the directors are honest in the management of the affairs of the corporation and seek to properly protect the interests of the

⁹⁰ *McClure v. Law*, 161 N. Y. 78, 55 N. E. 388, 76 Am. St. Rep. 262.

⁹¹ *Mosher v. Sinnott*, 20 Colo. App. 454, 79 Pac. 742.

stockholders, they may escape liability resulting from the fraudulent acts of the board or directors, if they will use the means at hand for the proper protection of themselves and their corporation.⁹²

The first thing necessary is the dissenting vote of the directors seeking to escape liability for the fraudulent acts of the board, which dissenting vote shall be entered of record on the minutes of the meeting of the board of directors at the time the act is done. In addition to this, such director should forthwith convey notice to the stockholders of the corporation whose interest he is always bound to protect. This notice may be given by publishing the same, or by personal notice.

While in most cases a notice to the stockholders is not required, yet, if the director is acting in good faith, he will not hesitate to convey to the stockholders his petition and appeal to them for protection.

Leaving now the question that might be raised under acts that are either actual or constructive fraud, we come to the issues arising under the law applicable to the duties of the directors. Upon this proposition, it may be said generally, that the first duty of each director of the corporation is to carry out the objects and purposes for which the corporation was organized, in accordance with its charter and adopted by-laws. He has no right to ignore or wilfully violate either the provisions of the charter, or the by-laws of the corporation.

It is his duty not only to protect the corporate property for the corporation and its stockholders, and to act always in the utmost good faith toward both, but always to use reasonable care and diligence in managing the affairs of the corporation. If the directors undertake to delegate their duties to an officer, or intrust the management of the corporate affairs wholly in his

⁹² *Seigman v. Electric Vehicle Co.*, 140 Fed. 117.

hands, they will be liable for his misconduct and mismanagement. The degree of care and diligence required of a director is expressed in various terms by many of the decisions.

"The directors of a corporation in administering its affairs must exercise ordinary care, skill and diligence. They must give the business under their care such attention as an ordinarily discreet business man would give to his own concerns under similiar circumstances, and it is incumbent upon them to devote so much of their time to their trust as is necessary to familiarize them with the business of the institution and direct its operations," and, "if the board of directors of the corporation delegate its business and the whole management and control thereof to its executive officers, they cannot, when disaster to the stockholders and creditors ensues through carelessness and mismanagement, avoid personal liability on the ground that they did not know of the unfortunate transactions, and were ignorant of the business." ⁹³

Of course, directors should not be chargeable for mere errors of judgment, nor for injuries arising from unforeseen or unpreventable contingencies, if they exercised that degree of care, skill and diligence as has just been pointed out.⁹⁴ "And where trustees have intended to discharge their duties fairly, I think they should be treated with tenderness and due caution taken not to hold them liable upon slight and uncertain grounds, lest by a different policy, men of integrity and who would be actuated by the proper views, may be deterred from taking upon themselves an office so necessary in the concerns of life, for fear of the anxiety, trouble and risk which it involves." ⁹⁵

⁹³ Warren v. Robison, 19 Utah, 289, 57 Pac. 287, 75 Am. St. Rep. 734.

⁹⁴ Waterman v. Alden, 144 Ill. 90, 32 N. E. 972.

⁹⁵ Elliott v. Carter, 59 Gratt. 541.

And the courts are now quite uniform upon the proposition that directors of a corporation are not liable for mistakes and errors committed while in the performance of their duties as such, provided the acts are done in good faith, and not the direct result of ignorance, or gross neglect of duty.⁹⁶

On the other hand, there can be no question that directors will be held liable for all damages resulting from gross negligence, or wilful inattention to their duties.⁹⁷

Thus, it has been held that, where the directors of a corporation, as a result of their negligence, failed to renew the bond of a corporate officer, as required by the by-laws, and negligently allowed it to lapse and become void, they were liable for the loss thereby resulting to the corporation;⁹⁸ and where the board of directors intrusted the management of the corporation to its president, they believing him to be honest, faithful and competent, they are personally liable for his misappropriation of the corporate funds.⁹⁹

Even where the directors do not attend the meetings of the board of directors, they will be personally liable

⁹⁶ *Hodges v. N. E., etc. Co.*, 1 R. I. 312, 53 Am. Dec. 624; *Neal v. Hill*, 16 Cal. 145; *Godbold v. Branch Bank*, 11 Ala. 191, 46 Am. Dec. 211; *Williams v. McDonald*, 37 N. J. Eq. 409, 42 N. J. Eq. 392, 7 Atl. 866.

⁹⁷ *Thomas v. Penniman*, 105 Md. 475, 66 Atl. 291; *Fisher v. Parr*, 92 Md. 245, 48 Atl. 621; *Bosworth v. Allen*, 168 N. Y. 157, 61 N. E. 163, 55 L. R. A. 751, 85 Am. St. Rep. 667; *Fletcher v. Eagle*, 74 Ark. 585, 86 S. W. 810, 109 Am. St. Rep. 100; *Williams v. Hilliard*, 38 N. J. Eq. 373; *Williams v. McKay*, 40 N. J. Eq. 189, 53 Am. Rep. 775; *Marshall v. Farmers' S. Bank*, 85 Va. 676, 8 S. E. 586, 2 L. R. A. 534, 17 Am. St. Rep. 84; *Hun v. Cary*, 82 N. Y. 65, 37 Am. Rep. 546; *Bank v. Hill*, 56 Me. 385, 96 Am. Dec. 470; *Young v. Equitable Life Ins. Co.*, 99 N. Y. Supp. 446; *Seigman v. Electric Vehicle Co.*, 140 Fed. 117; *Wietze v. Burrage*, 190 Mass. 267, 76 N. E. 508.

⁹⁸ *Murphy v. Penniman*, 105 Md. 452, 66 Atl. 282.

⁹⁹ *Fletcher v. Eagle*, 74 Ark. 585, 86 S. W. 810, 109 Am. St. Rep. 100.

for the consequences of their nonfeasance, or for gross negligence that may result in a breach of their trust to the damage of the stockholders of the corporation.¹⁰⁰ Commenting upon the last suggestion, Lord Chancellor Hardwicke many years ago said: "If some persons are guilty of gross nonattendance, and leave the management entirely to others, they may be guilty by this means of the breaches of trust that are committed by others. By accepting a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence; and it is no excuse to say that they had no benefit from it, but that it was merely honorary; and therefore they are within the case of common trustees. Another objection has been made that the court can make no decree upon these persons which will be just, for it is said every man's nonattendance, or omission of his duty is his own default, and that each particular person must bear such a proportion as is suitable to the loss arising from his particular neglect, which makes it a case out of the power of this court. Now, if this doctrine should prevail, it is indeed laying the axe to the root of the tree. But if, upon inquiry before the master, there should appear to be a supine negligence in all of them, by which a gross complicated loss happens, I will never determine that they are not all guilty. Nor will I ever determine that a court of equity cannot lay hold of every breach of trust, let the person be guilty of it either in a private or public capacity." ¹⁰¹

¹⁰⁰ *Fisher v. Parr*, 92 Md. 245, 48 Atl. 621; *Selgman v. Electric, etc. Co.*, 140 Fed. 117; *Warren v. Robison*, 19 Utah, 289, 57 Pac. 287, 75 Am. St. Rep. 734; *Marshall v. Farmers' & Mechanics' Bank*, 85 Va. 676, 8 S. E. 586, 2 L. R. A. 534, 17 Am. St. Rep. 84.

¹⁰¹ *Warren v. Robison*, 19 Utah, 289, 57 Pac. 287, 75 Am. St. Rep. 734.

The Supreme Court of Virginia commenting upon this question says: "Losses resulting from the fact that such directors did not attend to the business of the bank, absented themselves from regular meetings of the board of directors, and through their inattention permitted officers of the bank to withdraw money or property without authority, and other persons to largely overdraw their accounts, and notes to be rendered uncollectible from want of proper security, or from not being properly protected, or enforced by appropriate proceedings. The fact that any particular director did not know of these wrong doings will not exonerate him, because he could not be without such knowledge, except from his own negligence."¹⁰²

It will thus be seen, from the brief reference that we have made to the decisions of the different courts, that when a person voluntarily takes the position of director, certain duties and liabilities are imposed upon him by law. Summing up such briefly, we would say that his first duty is to attend the meetings of the board of directors, unless there is good and sufficient reason for not attending; his second duty is to familiarize himself with the general business affairs of the corporation; his third duty is to see to it, in so far as he is able, as a director, that the affairs of the corporation are carried on fairly and honestly and in the interest of the corporation and its stockholders; his fourth duty is to see that honest and efficient officials and officers are elected and appointed, and, when elected and appointed, that they do their duty toward the corporation and its stockholders under the charter and by-laws, and properly care for the interests of the corporation and its stockholders.

In this connection, it should be said that directors

¹⁰² *Marshall v. Farmers', etc. Sav. Bank*, 85 Va. 676, 8 S. E. 586, 2 L. R. A. 534, 17 Am. St. Rep. 84.

should not delegate their duties to officers, nor should they permit the officers to go on from time to time making contracts and doing acts outside of their duties as prescribed by the by-laws and the orders of the board of directors; their fifth duty is to prevent the property of the corporation from being wasted, misapplied or misappropriated in any way. It is needless for us to suggest that it is the directors' duty at all times and under all circumstances to prevent wrongful, fraudulent or deceitful acts from being perpetrated upon the corporation and its stockholders by his fellow directors. It must not be forgotten that by the acceptance of the position as director, such person impliedly agrees that he will faithfully, honestly, and to the best of his ability discharge the duties incident to such office, and unless a director intends to do this, it is better that he never accept such a position.

It is to be admitted, however, regretfully, that often boards of directors of corporations never seem to realize that it is their legal and moral duty to the stockholders of the corporation to give to their office the time and attention, the care and prudence, the honesty and efficiency that is necessary to properly promote the corporate interests and properly protect the corporate property, and bring results to its stockholders. Too often directors seem to be satisfied with meeting occasionally in a haphazard manner, permit the officers to run the corporation to suit themselves and quietly acquiesce in all their transactions. This is wrong and should never be permitted. The success of the average mercantile, manufacturing, or mining company will often depend upon the honesty, intelligence and judgment of its board of directors.

Where there is any doubt as to the right of the directors of a corporation to do certain acts, the board will always find it safer and better to call a stock-

holders' meeting and have them authorize the proposed action. In other words the board of directors should never assume the liability and responsibilities incident to making a contract in the name of the corporation beyond their power and authority, as this will often involve them in serious litigation and fix upon them liabilities for their action. There is no question that the directors are under a strict degree of accountability for all *ultra vires* or unlawful acts.

Generally speaking where the stockholders and creditors do not complain, there is no one else entitled to a standing in court.¹⁰³ Where directors do some act in the corporate name beyond their power as directors, but within the power of the corporation, their acts may be made legal by subsequent ratification by the stockholders.¹⁰⁴ It has even been held that where the corporation acquiesces in an unlawful transaction on the part of its officers for more than two years it is in effect a ratification of the unauthorized act.¹⁰⁵

It has been a familiar practice to place in the articles of incorporation certain restrictions on the acts of the board of directors, such as, requiring a two-thirds vote of the stockholders before a mortgage could be authorized, or the property of the corporation sold. In some cases this has been carried to the extent of requiring that, before the corporate property could be sold, or disposed of, it was necessary to call a stockholders' meeting and secure a vote of a certain per cent of the

¹⁰³ *Benbow v. Cook*, 115 N. C. 324, 20 S. E. 453, 44 Am. St. Rep. 454; *Lincoln Mountain Min. Co. v. Williams*, 37 Colo. 193, 85 Pac. 844.

¹⁰⁴ *Miller v. Wash. Southern R. R. Co.*, 11 Wash. 414, 39 Pac. 673; *Beach v. Miller*, 130 Ill. 162, 22 N. E. 464, 17 Am. St. Rep. 291; *Starr v. Gregory Con. Min. Co.*, 6 Mont. 485, 13 Pac. 195; *Blake v. Domestic Mfg. Co.*, — N. J. Eq. —, 38 Atl. 241; *Pitcher v. Lone Pine, etc. Co.*, 39 Wash. 608, 81 Pac. 1048.

¹⁰⁵ *Miller v. Wash. Southern R. R. Co.*, *supra*.

outstanding stock. All such stock provisions are doubtless provided for the protection of the minority stockholders.

Vacancies. Vacancies in the board of directors caused by the resignation, death or refusal of a director to act, shall be filled by the other directors in office, and such person so selected shall hold office until the first meeting of the stockholders.

This provision is more or less important in the by-laws for the reason that, without authority in either the statute, charter or by-laws, the remaining directors would have no right to appoint a person to fill a vacancy caused by the death, resignation or refusal of a director to act. Thus, it would make it necessary to call a special meeting of the stockholders to fill such vacancies in the board.¹⁰⁶

Under this provision the directors can meet and appoint some person to fill the vacancy caused, with very little trouble and expense. It will be found advisable as soon as a vacancy is caused in the board of directors, to call the balance of the board of directors together and appoint some person to fill the vacancy, otherwise other vacancies might occur in the board of directors until there was not a quorum left, which would necessitate the calling of a special meeting to fill the vacancies. During the time intervening between the call and the holding of the meeting, the corporation would be without a board of directors.

A number of the states now have statutes authorizing the removal of directors by a certain vote of the stockholders. Such action would cause a vacancy within the meaning of the above provision, and should be filled by the remaining directors in office and not by the stockholders. Of course a majority of the full board

¹⁰⁶ Conyngton on Corporate Management, p. 960.

will always be necessary to hold a legal meeting, even for the election of directors to fill vacancies. It is sometimes provided in the by-laws that the remaining directors by affirmative vote of the majority of the board of directors may fill the vacancies. Under such a provision in the by-laws, it would be necessary to have a full majority for the person to be elected; such a provision is liable to mislead the directors in office and is not always advisable.

Regular Meetings. Regular meetings of the board of directors shall be held on the last Tuesday of the months of January, April, July and October, if not a legal holiday, and if a legal holiday, on the day following. In addition they shall meet regularly on the date of the annual stockholders' meeting, immediately after said stockholders' meeting shall have adjourned.

The directors may hold their meetings, and may have an office, and keep the books of the company in such place or places, within or without the state, as the board from time to time may determine.

In all cases where meetings shall have been held by the board of directors without the state, or at some place other than the principal place of business of the corporation within the state, a certified copy of the records and minutes, of such meeting or meetings shall be filed in the office at the principal place of business of the corporation.

No notice shall be required for any regular meeting of the board.

It is impossible to lay down any hard and fast rule for the holding of the regular meetings of the board of directors. The nature of the business of the corporation, the extent of its development, and many other things must be taken into consideration. It is not advisable to meet too often where there is little or no

business to be transacted, as meeting and adjourning without transacting any business will cause the directors to lose interest in the corporation. On the other hand they should meet often enough to manage the business affairs of the corporation and keep in close touch with the general purpose and status of the corporation business.

While the corporation must have an executive head in its proper officers, yet it is never advisable to leave everything to such officers, but a careful check always should be kept on their acts. Quarterly meetings in the average mercantile, mining or industrial corporation are generally regarded as sufficient and advisable. In addition to such quarterly meetings, it is sometimes necessary to provide that they shall meet immediately after the adjournment of the stockholders' meetings. It is a very easy matter to call and hold special meetings, even if regular meetings are provided for, or even adjourn the regular meeting from time to time, and thus keep it alive when the business interests so demand.

It is always to be remembered that all corporate contracts are made and authorized by the directors, and in the making of such contracts they must meet and act as a board in some legal meeting, and cannot authorize or make contracts by individual action.¹⁰⁷ In other words, a director of a corporation has no authority as a director to act for the corporation except in his place as a member of the board of directors, and he acquires

¹⁰⁷ *Hillyer v. Overman Silver, etc. Co.*, 6 Nev. 51; *Brinkerhoff Zinc Co. v. Boyd*, 192 Mo. 597, 91 S. W. 523; *Guillaume v. K. S. D. Land Co.*, 48 Ore. 400, 86 Pac. 883, 88 Pac. 586; *Dockstader v. Y. M. C. A. of Des Moines (Iowa)*, 109 N. W. 906; *Alta Silver Mining Co. v. Alta Placer Mining Co.*, 78 Cal. 629, 21 Pac. 373; *Farrell v. Gold Flint Mining Co.*, 32 Mont. 416, 80 Pac. 1027; *Audenreld v. East Coast Milling Co. (N. J. Eq.)*, 59 Atl. 577; *Garmany v. Lawton*, 124 Ga. 876, 53 S. E. 669, 110 Am. St. 207.

no additional authority to act for the corporation from the fact that he owns a majority of the corporate stock.¹⁰⁸

It will thus be seen from what already has been said that it is absolutely necessary that some provision be made in the by-laws for the meetings of the directors, and it is also necessary to provide either in the charter or the by-laws, for the time and place of holding the regular meetings, in which event a meeting must be held at the place and time fixed. The fact however that the by-laws provide for regular meetings, and make no provisions for special meetings does not prevent the corporation from calling and holding special meetings.¹⁰⁹

In the absence of any designated place in the by-laws, meetings of the board of directors may be held in any convenient place within the state. Where the charter, by-laws, or governing statute require that all meetings of the directors must be held within the state of the incorporation, they cannot legally be held in any other state.

In the absence of such requirement, however, it would seem that the directors can lawfully meet outside of the state of incorporation and authorize and transact the business of the corporation.¹¹⁰

Thus it has been held that a mortgage executed out-

¹⁰⁸ *Clement et al. v. Young-McShea Amusement Co.* (N. J.), 67 Atl. 82. See also *Cent. Digest*, vol. 12, Corporations, secs. 1274, 1593, 1594.

¹⁰⁹ *Ashley Wire Co. v. Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187.

¹¹⁰ *Smith v. Silver Valley Min. Co.*, 64 Md. 85, 20 Atl. 1032, 54 Am. Rep. 760; *Bassett v. Monte Cristo Gold Min. Co.*, 15 Nev. 293; *Humphreys v. Mooney*, 5 Colo. 282; *Wood Hydraulic Hose Co. v. King*, 45 Ga. 34; *Mo. Lead Min. Co. v. Reinhart*, 114 Mo. 218, 21 S. W. 488, 35 Am. St. Rep. 746; *Handley v. Stutz*, 139 U. S. 417, 35 L. Ed. 227.

side of the state is valid;¹¹¹ and so also contracts conveying property of the corporation;¹¹² or the directors may make an assignment for the benefit of creditors;¹¹³ or authorize the issuance of bonds;¹¹⁴ or elect a secretary of the corporation.¹¹⁵ On the other hand it has been held that before a valid meeting can be held outside of the state creating the corporation, affirmative authority must be given by the governing statute; thus¹¹⁶ corporate acts performed by the managing body of the corporation outside of the state creating such corporation have been held to be void.¹¹⁷ It has been held that they cannot elect corporate officers outside of the state creating the corporation;¹¹⁸ nor levy calls nor assessments.¹¹⁹

The statutes of many of the states now expressly permit the directors to meet outside of the state of incorporation for the transaction of corporate business. This is true in New Jersey, Montana and many other states. On the other hand a few of the states have express statutory provisions requiring the directors' meetings to be held within the state. Of course the persons who participate in such meetings, that is meetings held outside of the state creating the corporation,

¹¹¹ *Saltmarsh v. Spaulding*, 147 Mass. 224, 17 N. E. 316; *Ames v. Conant*, 36 Vt. 744; *Bassett v. Monte Cristo Co.*, 15 Nev. 293.

¹¹² *Mo. Lead Min. etc. Co. v. Reinhart*, 114 Mo. 218, 21 S. W. 488, 35 Am. St. Rep. 746.

¹¹³ *Wright v. Lee*, 2 S. D. 596, 51 N. W. 706.

¹¹⁴ *Galveston, etc. Co. v. Cowdrey*, 11 Wall. 459, 20 L. Ed. 199; *Bassett v. Monte Cristo, etc. Co.*, 15 Nev. 293.

¹¹⁵ *McCall v. Byram, etc. Co.*, 6 Conn. 428.

¹¹⁶ *Brockway v. Gadsden, etc. Co.*, 102 Ala. 620, 15 So. 431; *McArmby v. Vt. Copper Co.*, 56 N. Y. 623.

¹¹⁷ *Aspinwal v. Ohio, etc. R. R. Co.*, 20 Ind. 492, 83 Am. Dec. 329; *Miller v. Ewer*, 27 Me. 509, 46 Am. Dec. 619.

¹¹⁸ *Place v. People*, 87 Ill. App. 527.

¹¹⁹ *Aspinwal v. Railroad Co.*, 20 Ind. 492, 83 Am. Dec. 329.

cannot afterward complain or take any advantage by reason of that fact.¹²⁰

It is to be noted that according to the above by-law provision, no notice of regular meetings of the directors is contemplated as none is necessary. The law is now well settled that where the by-laws or charter fix the hour, time and place of holding certain meetings no further notice of such meetings will be necessary.¹²¹ Even in the absence of such a by-law provision, it has been held that the majority may bind the minority in ordinary business transactions without giving such minority notice of the meeting;¹²² and it has been held: "where the record of a directors' meeting recites that notice was given to the directors, this is *prima facie* evidence to sustain the validity of the proceedings of such meeting."¹²³

Hence there is no necessity of cumbering the by-laws with unnecessary provisions, especially when those provisions are more liable to involve the incorporation in trouble than to lead to any good results.

If the by-laws require a certain notice to be given, then of course, it must be given in the method and form therein prescribed;¹²⁴ and unless so given may involve the corporation in serious trouble and often litigation.¹²⁵ "That all directors are entitled to notice

¹²⁰ *McConnell v. Com. Min. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 708; *Wood v. Boney*, 21 Atl. 574.

¹²¹ *Doernbecher v. Columbia City Lmbr. Co.*, 21 Ore. 573, 28 Pac. 899, 28 Am. St. Rep. 766; *Thompson v. West*, 59 Neb. 677, 82 N. W. 13, 49 L. R. A. 337.

¹²² *Buck v. Troy Aqueduct Co.*, 76 Vt. 75.

¹²³ *Turner v. Fidelity Loan Concern*, 2 Cal. App. 122, 83 Pac. 62.

¹²⁴ *Westcott v. Minn. Min. Co.*, 23 Mich. 145.

¹²⁵ *Thompson v. Williams*, 76 Cal. 153, 18 Pac. 153, 9 Am. St. Rep. 187; *Hill v. Rich Hill Min. Co.*, 119 Mo. 9, 24 S. W. 223; *Curtin v. Salmon River, etc. Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *Waterman v. Chicago, etc. Co.*, 139 Ill. 658, 29 N. E. 689, 15 L. R. A. 418, 32 Am. St. Rep. 228.

either expressed or implied of any meeting at which any business is to be transacted in order that business may be binding upon all persons concerned, admits of no question; if the meetings held are regular meetings, that is such as are provided by the charter or by the by-laws, fixing the time and place, then notice thereof is implied." ¹²⁶

"If a regular meeting of the board of directors, of which no notice is required is adjourned to the next day, but the hour to which it is thus adjourned is not stated and two directors are not present, and no notice is given of the adjourned meeting, and these two directors have no knowledge of it, an assessment levied at such adjourned meeting is a nullity." ¹²⁷

It has been held that a resolution of a corporation adopted at a meeting of its board of directors, signed by the president and secretary of the selling corporation and delivered to the purchaser, constitutes a full compliance with the requirements of the statute of frauds as a memorandum in writing signed by the persons to be charged. ¹²⁸

Legal meetings of the directors may be held, although the by-laws are silent on the subject. ¹²⁹ However it is advisable to provide for meetings in the by-laws.

Special Meetings. Special meetings of the board of directors may be held at any time at the principal place of business of the company, or may be held at any time or place by the unanimous consent of all the directors, which consent shall be

¹²⁶ Thompson v. West, 59 Neb. 677, 82 N. W. 13, 49 L. R. A. 337.

¹²⁷ Thompson v. Williams, 76 Cal. 153, 9 Am. St. Rep. 187, 18 Pac. 153.

¹²⁸ Western Timber Co. v. Kalama, etc. Co., 42 Wash. 620, 85 Pac. 338, 114 Am. St. 137.

¹²⁹ United Growers' Co. v. Eisner, 47 N. Y. S. 906.

executed in writing by such directors and filed among the permanent records of the corporation. Special meetings may be called either by the president or board of directors, on the request of one third of the members of the board of directors. The call and notice for all special meetings shall state the time, the hour and the place of the holding of such meetings and a clear description of the business to be transacted thereat. Each director of the corporation shall be entitled to a notice of the meetings, which shall be given by the secretary in writing at least five days next preceding the date of such meeting.

It is proper in all corporations that the by-laws provide for the calling and holding of special meetings. In the absence of provision in the by-laws, special meetings may be held at any convenient place within or without the state, that is of course in the absence of statutory and charter restrictions.¹²⁰

The most important thing in connection with the special meeting of the directors is a proper notice, properly served. The secretary should always see to it that the by-laws are complied with to the exact letter in all things pertaining to special meetings. The notice must contain the time, place and purpose of the meeting, set out in plain, understandable language, and served as the by-laws require upon each of the directors. The law is settled that special meetings of the directors will be void, and the attempted business a nullity, if each and every member thereof has not been served with a notice as the by-laws require.¹²¹

¹²⁰ *Ashley Wire Co. v. Steel Co.*, 164 Ill. 149, 45 N. E. 410, 56 Am. St. Rep. 187.

¹²¹ *Curtin v. Salmon River, etc. Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. 132; *Relley v. Camel*, 134 Cal. 175; *Thompson v. Williams*, 76 Cal. 153, 9 Am. St. Rep. 187, 18 Pac. 153; *Patch v. Lucky Bill Min. Co.*, 25 Utah, 405, 71 Pac. 865.

Thus it will be seen that the corporation may be plunged into serious and troublesome litigation, unless proper and legal notice is given each director. If it appears that a special meeting of the directors of a corporation was held and that a quorum was present, it must be presumed that due notice of the meeting was given and that all steps necessary to constitute it a regular and valid meeting were taken.¹³²

Quorum. A majority of the whole number of directors shall be necessary to constitute a quorum for the transaction of business. A majority of the directors present and constituting such a quorum shall be sufficient to determine any question or decide any matter brought before the board of directors. Whenever there is not a quorum present at any meeting of the board of directors, the directors present shall have the right to adjourn the meeting from time to time, but shall have no right to transact any other business of any kind or character.

Without express statutory or by-law authority, less than a quorum of a corporation has no power to adjourn a regularly called meeting to another date so as to make transactions at a meeting on such date valid.¹³³

We have heretofore noted that in the absence of statutory and charter restrictions to the contrary, any number of stockholders may constitute a quorum for the transaction of business, providing such number is fixed in the by-laws. A different rule, however, applies to the board of directors.

A majority of the board in all cases is necessary to constitute a legal quorum to transact business, that is,

¹³² *Singer v. Salt Lake Mfg. Co.*, 17 Utah, 143, 70 Am. St. Rep. 773, 53 Pac. 1024.

¹³³ *Cheney v. Canfield*, 158 Cal. 342, 111 Pac. 92, 32 L. R. A. (N. S.) 17.

where nothing to the contrary appears in the statute, charter or by-laws.¹³⁴ Therefore less than a majority of the full board of directors cannot under any circumstances transact legal business. The directors cannot act by proxy or power of attorney. The theory of the law is that the corporation is entitled to their joint judgment, deliberation and action, and that they must be at the corporate meeting in person. Even though there may be vacancies on the board of directors, yet, the law requires that there be a full majority of the board in order to constitute a quorum.

Where the board of directors, without a legal quorum have passed upon any matter, such matter may thereafter be ratified either by the stockholders or a legal meeting of the directors. "A director is disqualified from acting in any manner in his official capacity for the purpose of creating an obligation of the corporation in his own favor; hence a meeting at which there is not a majority of directors exclusive of such interested director, is not a competent board for the transaction of any corporate business."¹³⁵

In other words, where a director has a personal interest in the business under consideration, he cannot be counted to make up the necessary quorum, but by that interest he loses his capacity as a director.¹³⁶

¹³⁴ Calumet Paper Co. v. Haskell Show Printing Co., 144 Mo. 331, 45 S. W. 1115, 66 Am. St. Rep. 425; Curtin v. Salmon River, etc. Co., 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; Smith v. Los Angeles Immigrant, etc. Ass'n, 78 Cal. 289, 12 Am. St. Rep. 53, 20 Pac. 677.

¹³⁵ Curtin v. Salmon River, etc. Co., 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132.

¹³⁶ Jones v. Morrison, 31 Minn. 140, 16 N. W. 854; Van Hook v. Sommerville Mfg. Co., 5 N. J. E. 137; Copeland v Johnson Mfg. Co., 47 Hun, 235; Butts v. Wood, 37 N. Y. 317; Parsons v. Tacoma Smelter & Refng. Co., 25 Wash. 492, 67 Pac. 765; Camden Land Co. v. Lewis, 101 Me. 78, 63 Atl. 523; Wall v. Utah Copper Co., 70 N. J. E. 17, 62 Atl. 533.

Election of Officers. The board of directors shall, at their first regular meeting after the annual meeting of the stockholders, elect one of their number as President and one of their number as Vice-president. They shall also elect at such meeting a Secretary, Treasurer, General Manager, Auditor and General Counsel. Any officers elected or appointed by the Board of Directors may be removed by the affirmative vote of a majority of the whole Board of Directors. The Board may, in its discretion, appoint such other officers as they deem necessary.

Any person may be appointed an officer of a corporation if there is no by-law or charter restriction or qualification.¹⁸⁷ It is usual and in some states necessary, that the president and vice president be selected from among the board of directors. Indeed it is not an uncommon practice to select all the officers of a corporation from among the board of directors. However this is not always advisable. It is believed that the better plan, where practicable, is to select the secretary, general manager, treasurer, auditor and counsel outside of the board of directors, but from among the stockholders.

The compensation of all officers should be fixed immediately upon their election, as the courts hold that it is necessary for an officer to show a valid antecedent agreement before he can recover his salary.¹⁸⁸ Such

¹⁸⁷ *Wight v. Springfield, etc. Co.*, 117 Mass. 226, 19 Am. Rep. 412; *Lowe v. Ring*, 123 Wis. 370, 101 N. W. 698.

¹⁸⁸ *Curtin v. Salmon River Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *McConnell v. Com. Min. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703; *Crumlish v. Central Improvement Co.*, 38 W. Va. 390, 18 S. E. 456, 23 L. R. A. 120, 45 Am. St. Rep. 872; *Kilpatrick v. Penrose, etc. Bridge Co.*, 49 Pa. St. 118, 88 Am. Dec. 497; *Martindale v. Wilson Cass Co.*, 134 Pa. St. 348, 19 Atl. 680, 19 Am. St. Rep. 706; *St. Louis R. R. Co. v. O'Hara*, 177 Ill. 525, 52 N. E. 734, 53 N. E. 118; *Holder v. LaFayette, etc. Co.*, 71 Ill. 106, 22 Am. Rep. 89; *Butts*

officers cannot recover from the corporation on *quantum meruit* for services rendered the corporation in the discharge of their duties as prescribed by the by-laws.¹³⁹ This is especially true where such officers are directors of the corporation. In other words before an officer of a corporation is entitled to recover compensation provided for by the by-laws he must show a valid resolution fixing such compensation prior to the rendition of the services.

And where an officer appropriates or undertakes to retain property in his possession belonging to the corporation for such salary, he will be required to return such property to the corporation.¹⁴⁰ Under the above by-law provision, the directors would have the right to remove any officer at pleasure, therefore no contract should be made for a certain period of time with any officer, with the possible exception of the general counsel for the corporation. However, in such matters, the board of directors shall always be governed by their good judgment. The officers of the corporation will of

v. Woods, 37 N. Y. 317; *Hardee v. Sunset, etc. Co.*, 56 Fed. 51; *Cook on Corporations*, sec. 657, 21 Am. & Eng. Enc. of Law, 2d Ed. 905; *Home Mixture Co. v. Tillman*, 125 Ga. 172, 53 S. E. 1019; *Busell, Trimer Co. v. Coburn (Mass.)*, 74 N. E. 334; *Althouse v. Cough Colliery Co. (Penn.)*, 76 Atl. 316.

¹³⁹ *Burns v. Commencement Bay Co.*, 4 Wash. 558, 30 Pac. 668; *Santa Clara, etc. Ass'n v. Meredith*, 49 Md. 389, 33 Am. Rep. 264; *Citizen's Natl. Bank v. Elliott*, 55 Iowa, 104, 7 N. W. 470, 39 Am. Rep. 167; *Smith v. Long Island R. R. Co.*, 102 N. Y. 190, 6 N. E. 397; *Pew v. First Natl. Bank*, 130 Mass. 391; *Eaton v. Robinson*, 29 L. R. A. 100, 19 R. I. 146, 31 Atl. 1058, 32 Atl. 339; *Crumlish v. Central Improvement Co.*, 38 W. Va. 390, 18 S. E. 456, 23 L. R. A. 120, 45 Am. St. Rep. 872.

¹⁴⁰ *Emporium Real Estate Co. v. Emrie*, 54 Ill. 345; *Greenville Gas Co. v. Reis*, 54 Ohio St. 549, 44 N. E. 271; *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 523, 10 Cyc. 799, 21 Am. & Eng. Enc. of Law, 2 Edn. 911; *Fillebrown v. Hayward*, 190 Mass. 472, 77 N. E. 45; *Greathouse v. Martin (Tex.)*, 91 S. W. 385.

course qualify before assuming their duties by taking the usual oath of office.

Compensation of Directors. Each director of this company shall be entitled to receive as salary and compensation as director, the sum of \$5.00 for each meeting, regular or special, attended.

The by-laws should always contain some provision relative to the compensation of directors. The law is well settled that a trustee or director of a corporation cannot recover for performing such services as are within the line of his ordinary duties as such trustee, unless there is some express provision therefor in the governing statute, charter or articles of incorporation, or some other authority than the action of the board of trustees themselves.

Innumerable cases might be cited from different courts upholding this rule of law.¹⁴¹ This is true notwithstanding the fact that the directors among themselves understood that they were to receive pay or compensation for their services.¹⁴²

¹⁴¹ *McConnell v. Com. Min., etc. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703; *Burns v. Com. Bay, etc. Co.*, 4 Wash. 558, 30 Pac. 668; *Brown v. Valley View Min. Co.*, 127 Cal. 630, 60 Pac. 424; *Holder v. LaFayette, etc. Co.*, 71 Ill. 106, 22 Am. Rep. 89; *Cheaney v. LaFayette, etc. Co.*, 68 Ill. 570, 18 Am. Rep. 584; *Butts v. Woods*, 37 N. Y. 317; *Wood v. Lost Lake*, 23 Ore. 20, 23 Pac. 848, 37 Am. St. Rep. 651; *Martindale v. Wilson Cass Co.*, 134 Pa. St. 348, 19 Atl. 680, 19 Am. St. Rep. 706; *Kilpatrick v. Penrose Ferry Co.*, 49 Pa. St. 118, 88 Am. Dec. 497; *Fitzgerald v. Fitzgerald*, 137 U. S. 98, 34 L. Ed. 608; *Doe v. N. W. Coal Co.*, 78 Fed. 62; *Ten Eyck v. Pontiac Co.*, 74 Mich. 226, 16 Am. St. Rep. 633, 41 N. W. 905, 3 L. R. A. 378; *Crumlish v. Central Imp. Co.*, 38 W. Va. 390, 45 Am. St. Rep. 872, 18 S. E. 456, 23 L. R. A. 120; *Waterman v. Chicago, etc. Co.*, 139 Ill. 658, 32 Am. St. Rep. 228, 29 N. E. 689, 15 L. R. A. 418; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 56 Am. St. 203, 45 N. C. 954, 56 Atl. 426; *Porch v. Agnew Co. (N. J. E.)*, 61 Atl. 721, 70 N. J. 328; *Monmouth Inv. Co. v. Means*, 151 Fed. 159, 12 L. R. A. 154.

¹⁴² *Martindale v. Wilson Cass Co.*, 134 Pa. St. 348, 19 Am. St. Rep. 706, 19 Atl. 680.

Thus it would seem that the only proper way to avoid friction and possible unlawful acts will be to settle the question of compensation of directors in the by-laws, as it will often be difficult to satisfactorily explain to directors expecting pay for their services that the law will not permit the paying of such, unless authorized by statute, charter, by-laws or by action of the stockholders. Indeed the directors themselves may often become involved by voting salaries to themselves, for salaries may thereafter be recovered from the directors by the dissenting stockholders or creditors.

"Doubtless a director may perform extra labor and for it be justly entitled to compensation for his time and expenses, and this may be made out even without any express promise, for a promise may be implied from the peculiar and extraordinary services rendered, but then the services must appear to be of an extraordinary character, and this, beyond all question of doubt, for as a director he agrees to give his services and is entitled to make no charges whatever, however severe and protracted may be his labors. A different rule would lead to great abuses and corruption."¹⁴³

It is needless to suggest here that any attempt to vote "back salaries" or to pay a director for past services will be absolutely void.¹⁴⁴ Where the services of a director are entirely outside of his duties as director he may recover for such services, the value thereof,¹⁴⁵ and, it has been seen that the director is entitled to the return of advances made to his corporation or for serv-

¹⁴³ *New York, etc. Co. v. Ketchum*, 27 Conn. 170; also, *Burns v. Com. Bay Co.*, 4 Wash. 558, 30 Pac. 668; *Cheaney v. LaFayette, etc. Co.*, 68 Ill. 570, 18 Am. Rep. 584; *Gumaer v. Cripple Creek, etc. Co.*, 40 Colo. 1, 90 Pac. 81; *Henry v. Mich., etc. Ass'n*, 147 Mich. 142, 110 N. W. 523; *Bogardus v. N. Y., etc. Co.*, 102 N. Y. Supp. 1088.

¹⁴⁴ *Monmouth Inv. Co. v. Means*, 151 Fed. 159, 12 L. R. A. 154.

¹⁴⁵ *Bell v. Pepper, etc. Co. (Mo.)*, 103 S. W. 1014.

ices performed upon *quantum meruit* although an express agreement for such might be void.¹⁴⁶

Power to pass or amend by-laws. The directors shall have no power to pass, adopt, change, alter or amend these by-laws. They shall have power, however, to pass and adopt additional by-laws not inconsistent with these by-laws, the charter of the corporation or the statute of the state, that may be found necessary and proper to the interests of the corporation.

We have heretofore called attention to the fact that the stockholders have an inherent right to adopt, amend and repeal by-laws. The directors have no power to adopt or amend, or repeal by-laws unless such power is given them by the governing statute, the charter or by the by-laws. The better and safer practice is to permit the directors to pass additional by-laws not inconsistent with the laws of the state, the charter of the corporation or the by-laws already adopted by the stockholders, that may be found necessary and proper to facilitate the business of the corporation; by such a provision the directors have an opportunity to meet any unforeseen emergency or contingency and at the same time are required to confine their actions to the bounds of reason and safety. There is no denying the fact that if directors are given unlimited authority to make, alter and repeal by-laws at will, much abuse will often follow such permission.

It is impossible for the stockholders to keep in close touch with the business transactions of the board of directors of the corporation. Indeed it is to be noted on every hand that the stockholders of ordinary corporations pay little or no attention to its management, sel-

¹⁴⁶ *Shiveley v. Eureka, etc. Gold Min. Co.*, 5 Cal. App. 236, 89 Pac. 1073.

dom attend its meetings and trust everything to the board of directors and officers of the corporation. By reason of these facts, it is right and proper that the board of directors should be restricted to a certain extent in repealing, changing or amending the fundamental law of the corporation.

Offices. The board of directors shall have a right upon the affirmative vote of the entire board to establish such office or offices within or without the state creating this corporation as in their judgment is necessary to properly facilitate the business of the corporation, but under no circumstances shall it remove from the jurisdiction of the state creating this corporation, the original records, books and documents belonging to the corporation.

It is a common practice nowadays, for a corporation to keep and maintain in addition to the principal place of business, an office outside of the state of incorporation. This is of course absolutely necessary where the corporation is organized under the laws of a different state than wherein they intend to carry on their business. Again it will often be found advisable to establish offices in other states for the sale of corporate stock; therefore it is always advisable to insert authority for this in the by-laws, and where it is possible, to name and designate the place of such office or offices; however this will sometimes be a little difficult to do.

Generally speaking we recommend the above provision. The fact that the board shall have power to establish an office outside of the jurisdiction of the state creating the corporation, should not give them permission to remove the books, records, and everything belonging to the corporation to such office. It is better that these records and books of the corporation be kept at its principal place of business and only such offices

established outside of the state as may be necessary and proper to legally transact business.

Executive Committee. The president, general manager and counsel of the corporation shall be and constitute an executive committee, which committee shall have the same powers, rights and duties as the board of directors, when the board of directors is not in session; but shall have no power to increase, decrease or extend the plants and properties of the corporation, nor bond or mortgage or encumber the corporate property without the approval and consent of the stockholders representing not less than one half the outstanding stock. They shall meet at any time on the call of the president and a majority of such committee shall be sufficient to transact business.

The purpose of the above by-law provision is to furnish a committee with the powers, rights and duties of the board of directors, while such board of directors is not in session. For the ordinary industrial company we advise that this provision be omitted. Of course in large corporations with extensive interests, where it is difficult for the directors to meet very often, it has been found advisable to provide an executive committee with such powers and rights as the circumstances warrant.

Generally such committees are appointed by the board of directors from among their own number. The provision that we give here is that the president, the general manager and the counsel of the corporation shall constitute such committee because it is believed that if proper care has been exercised in the selection of these officers they are the more competent and trustworthy persons to transact the corporate business in the absence of the board of directors.

The president usually is or should be, in touch with the corporation and its entire business transactions. The general manager selected will be familiar with the operations and transactions of the corporation, while the counsel will furnish such legal advice as may be necessary; therefore, we say that if an executive committee is to be provided, it is better under all the circumstances that these three officers shall constitute such body. It is very difficult to lay down any hard and fast rule as to the powers of this committee, as such powers should be determined after taking into consideration the nature of the business and circumstances surrounding the same.

Care always should be taken that the executive committee is not used as a device to place the control of the corporation in the hands of two or three men, for this will lead to abuses and manipulations detrimental and dangerous to the interests of the corporation. Care should also be taken to see to it that this committee does not openly conflict with the general plan of operation as proposed by the directors. The stockholders should see to it that the executive committee does not furnish an excuse to the directors for not attending the corporate meetings and caring for the interests of the corporation. If there is any danger of the committee being used for either of the above purposes, then it is better that it be not created.

Such committee will of course, be required to keep full and complete records of its transactions and never should be permitted to embark in plans outside the ordinary and general business of the corporation or the general plan of the directors; nor should they be permitted to authorize the execution of important contracts. In short, generally speaking, they should be restricted to the usual and ordinary business transactions of the corporation. However, on the other

hand, it is next to impossible to undertake, in a by-law provision, to limit the powers and rights of an executive committee without either making such committee practically useless or placing the corporation in jeopardy. So that, all in all, it would seem that if an executive committee is provided for they should have the powers and rights as suggested in the by-law provision above given. There are authorities to the effect that the directors may delegate power to the executive committee by vote,¹⁴⁷ yet the better rule and practice is to provide for the executive committee and fix their powers in the by-laws. This is made so by reason of the fact that serious questions might arise as to what powers a board of directors could delegate to a committee, in the absence of by-law provisions.¹⁴⁸ There are authorities to the effect that a board of directors cannot delegate discretionary powers to an executive committee.¹⁴⁹ However, it is believed that the weight of authority holds to the opposite rule.¹⁵⁰

All questions of doubt can easily be eliminated by using the by-law provisions above suggested. Some cases have held that the entire committee is necessary to the transaction of corporate business.¹⁵¹ However, the great weight of authority holds that all that is necessary to transact business is a full majority of such committee.¹⁵² An executive committee cannot

¹⁴⁷ *Salem Iron Co. v. Lake Superior, etc. Co.*, 112 Fed. 239; *Gishwilder v. Willis*, 33 Cal. 11, 91 Am. Dec. 607; *Burrill v. Nahant Bank*, 43 Mass. 163, 35 Am. Dec. 395; *Leavitt v. Oxford, etc. Silver Min. Co.*, 3 Utah, 265, 1 Pac. 356.

¹⁴⁸ *Canada Atl., etc. Co. v. Flanders*, 145 Fed. 875.

¹⁴⁹ *Canada Atl., etc. Co. v. Flanders*, 145 Fed. 875; *Wedenfel v. Sugar, etc. Co.*, 48 Fed. 615; *Pike v. Bangor, etc. Co.*, 68 Me. 445; *Temple v. Dodge*, 89 Tex. 69, 32 S. W. 514, 33 S. W. 222.

¹⁵⁰ 21 Am. & Eng. Enc. of Law, 2d Ed. 856, and cases cited.

¹⁵¹ *Tracey v. Guthrie, etc. Society*, 47 Iowa, 27.

¹⁵² 21 Am. & Eng. Enc. of Law, 2d Ed. 857; *Cook on Corp.*, sec. 715.

delegate its discretionary powers;¹⁵³ nor can it bind the corporation beyond the power conferred. Generally speaking, the committee is subject to the same rules as the board of directors. Thus it is entitled to notice of meetings, unless the time is fixed in the by-laws.

Finance Committee. The board of directors shall elect and appoint from their number a finance committee, which committee shall consist of such number of the board, less than the total thereof and not less than three, as the board shall deem proper. The finance committee shall have power over and control of all financial affairs of the company. This committee shall fix its own rules of procedure and shall meet at such times and places as may be provided by such rules. All action by the finance committee shall be reported to the board of directors at its meeting next succeeding such action, and shall be subject to revision or alteration by the board of directors, provided that the rights or acts of third persons shall not be affected thereby. The president shall, ex officio, be chairman of the finance committee.

Many of the large industrial corporations now provide for a finance committee. Such a by-law provision is never advisable except in corporations having large and extensive business interests. For the ordinary corporation we recommend that no such provision be inserted in the by-laws, especially where provision is made for an executive committee.

Order of business. The order of business at directors' meetings shall be as follows:—first, roll call; second, reading and acting upon minutes of previous meetings; third, report of committees; fourth,

¹⁵³ 21 Am. & Eng. Enc. of Law, 2d Ed. 857.

election and appointment of officers; fifth, miscellaneous business.

The above by-law provision should not be adopted in ordinary corporations having a small board of directors. Indeed, an order of business is not indispensable in any corporation. In large corporations, having a large board of directors, an order of business tends to establish a more orderly system of conducting its business. In ordinary corporations with a small board, there is little or no use of such an order of business, as it would never be followed and in most cases not even noticed.

It is believed that the by-laws never should contain provisions that are not complied with by the directors, as this encourages a tendency to disregard any and all of the provisions of the by-laws at will. Hence, generally, it is just as well to eliminate from the by-laws an order of business, in so far as the board of directors is concerned.

Officers. The officers of the corporation shall be a president, vice-president, secretary, treasurer, general manager, auditor, and general counsel, which officers shall be elected and hold office at the pleasure of the board of directors. The compensation and tenure of office of all officers of the corporation other than directors, shall be fixed and determined by the board of directors.

As the corporation must be represented and make its contracts by its lawful agents called officers, it is necessary that such officers be elected and their duties defined. Generally speaking, officers of a corporation are governed by the same rules of law applicable to agents; however, there is fixed in them by the charter and by-laws certain rights and duties. The officers of the corporation might be confined to two persons, one

of whom could act as president and the other as secretary and treasurer.

As has so often been suggested in this work, the by-law must depend upon the nature of the corporate business, the scope of the enterprise, the volume of business to be transacted, and many other things. This is especially true as to the number of officers of the corporation, as well as the compensation. Thus, in a large corporation with a complicated organization and business covering a large scope, there is necessarily imposed upon the officers of the corporation duties and liabilities that do not exist in smaller companies. Hence in larger corporations, it is necessary to have special vice-presidents, as well as assistant secretaries, assistant treasurers, auditors, managing directors, etc., etc., all of whom have their duties defined in the by-laws. While in smaller organizations, with a few stockholders, transacting a small amount of business, the offices are sometimes, although never advisable, filled by two persons, that is, the president and the secretary-treasurer.

Between these two extremes, the officers must be selected according to the corporation needs or the scope of its business. It is generally advisable that a general counsel be retained by the corporation, and that there shall be some provision made for an auditor to audit its accounts. The president, of course, as has heretofore been pointed out, shall be elected from the directors themselves. The vice-president is also to be selected from among the directors, both of whom should be thoroughly familiar with the corporate business and capable and competent to carry the enterprise to a successful issue.

It will be noted that under the provisions of the by-laws here suggested, the officers are elected by and hold office at the pleasure of the board of directors, and un-

der such by-law provision the directors possess the right to discharge any officer at any time. All officers should be required to sign the usual oath of office immediately upon assuming their duties. It is hardly necessary under ordinary circumstances, to require any of the officers, except the treasurer and assistant treasurers to furnish a bond to the corporation.

Generally speaking, care always should be taken to select capable and careful men who are competent to fill the particular positions for which they are chosen. Thus the secretary should have a fair knowledge of stock transactions, bookkeeping, general office work, etc., while the general manager always should be experienced in the actual business carried on by the corporation. Men of standing and integrity will give strength to the corporate enterprise, security to the stockholders, and will extend the promotion of the objects and purposes to a successful issue.

The first great obligation imposed upon all officers of the corporation is to discharge the duties incident to their respective offices, according to the charter, the laws of the state and by-laws, rules and regulations of the corporation, in such a manner as to properly preserve the corporate property and protect the corporate interests. While officers are not strictly speaking trustees of the stockholders, nevertheless, they must at all times, act in the utmost good faith and their dealings must be free from fraud and deceit.

They are required to preserve, at all times, the corporate property and see to it that the same is not wasted nor destroyed. They must represent and protect the interests of all of the stockholders alike, they are not permitted to discriminate against one stockholder in favor of another. They should file all proper and necessary reports, required by the statute of the state wherein the business is organized, or where it is

carrying on and conducting its business. They are required to call all meetings provided for in the by-laws, and give proper and necessary notices to the stockholders and the directors of all such meetings.

For failure to carry out and perform any of these duties imposed upon them by law, and the charter and by-laws of the corporation, the officers will often be subjected to liabilities which are discussed more fully hereinafter.

It is impossible in the limited space allotted to this subject, to discuss very fully the personal liabilities of officers of a corporation, as a full digest of this branch of the law would necessitate a very lengthy article.

The liability of officers of corporations, like other agents is not necessarily confined to acts growing out of contracts, but may include acts growing out of torts as well. There is no question that officers are liable for mismanagement of the corporate business, or for the misappropriation, waste or willful destruction of the corporate property. The most prevalent class of liabilities growing out of contracts made by the officers of the corporation is, contracts made in the name of the corporation, but which are not under any circumstances binding upon the corporation; the second class is where contracts have been made in the name of the corporation, upon the assumption that the corporation is a legal entity, or legally organized, when as a matter of fact, there is no corporation.

While there is considerable doubt whether an officer of a corporation can be held personally liable for contracts that do not bind the corporation, yet there is enough doubt that the officers should never indulge in making contracts unless they have authority given them for so doing by the board of directors, and know, too, that the authority thus given them by such

board, does not extend beyond the purposes for which the corporation was organized. On the second proposition, the general law of agency governs and controls that particular class of contracts, and the corporate officer will be bound by the same rules that apply to an agent pretending to represent a principal who is not in existence.¹⁵⁴

That rule is to the effect that persons assuming to act as officers of a corporation are personally liable where there was no corporation to be bound.¹⁵⁵ Where the corporate officer expressly represents himself as possessing authority and these representations are relied upon by the principal in entering into the contract, the contract may be construed as the agent's and the liabilities held against him as if he had executed the contract in his own name.¹⁵⁶

All the authorities seem to agree, however, that no action can be maintained upon the contract itself, but that the liability is predicated upon the wrong done by him in falsely assuming to possess the necessary authority to act as an officer. The officers are not only liable to third persons for wrongfully entering into contracts; but they are also liable to the corporation for any wrongs perpetrated upon it, or upon the corporate property.

This liability grows out of the fact that officers of the corporation, by reason of their position, stand to a

¹⁵⁴ Mechem on Agency, sec. 557.

¹⁵⁵ *Hall v. Crandall*, 29 Cal. 567, 89 Am. Dec. 64; *Kaiser v. Lawrence Savings Bank*, 56 Iowa, 104, 8 N. W. 772, 41 Am. Rep. 85; *Walton v. Oliver*, 49 Kan. 107, 30 Pac. 172, 33 Am. St. Rep. 355; *Farmers', etc. Co. v. Floyd*, 47 Ohio St. 525, 26 N. E. 110, 12 L. R. A. 346, 21 Am. St. Rep. 846.

¹⁵⁶ *Dale v. Donaldson, etc. Co.*, 48 Ark. 188, 2 S. W. 703, 3 Am. St. Rep. 224; *Knickerbocker v. Wilcox*, 83 Mich. 200, 21 Am. St. Rep. 595; *Keener v. Herod*, 2 Md. 63; *Frankland v. Johnson*, 147 Ill. 520, 37 Am. St. Rep. 234, 35 N. E. 480.

certain extent in a fiduciary relation to the stockholders, and a number of courts have held that, by reason of this relation, they are liable to the corporation for loss flowing from their mismanagement of the corporate affairs. While this class of questions arises more often where the directors are guilty of mismanagement, or willful and gross neglect of duty, it is believed that the same rules that are laid down in the case of the director's liability will be applied to certain forms of abuses practiced by officers upon the corporation.

Many of the states have statutes requiring that the officers shall file certain periodical reports with the state officials. These statutes usually provide a penalty for failure to comply therewith, which penalty varies all the way from making the officer liable for the debts of the corporation, to punishment by fine and imprisonment. So too, an officer always is liable for any false and fraudulent statement made in connection with the affairs of the corporation, and is not only liable to those to whom the representation or false and fraudulent statements are made, directly, but where a statement is made to one person with the purpose that such a person shall communicate it to another, or where the false or fraudulent statement is contained in circulars or reports, and such reports and circulars are read and relied upon by persons to their damage and detriment, the officer making such statements or authorizing such statements to be published, will be liable to persons relying upon and damaged by such statements.¹⁵⁷

It is of course immaterial as to the purpose of making or circulating false and fraudulent reports, circulars or statements, but if it is done to accomplish

¹⁵⁷ *Westervelt v. Demorest*, 46 N. J. L. 37, 50 Am. Rep. 400.

some purpose of the corporation, and such statements have been relied upon to the damage of any person, the officer making or authorizing the same will be liable.¹⁵⁸ So too officers of a corporation have been personally liable for issuing certificates of stock in excess of the amount authorized by the articles of incorporation.¹⁵⁹ Officers are liable for torts, that is wrongs committed by them;¹⁶⁰ and it has been held that it is wholly immaterial that such officer was authorized by his principal to commit the wrongful act complained of.¹⁶¹

The question whether or not the corporate officers are liable for negligence, is clouded with uncertainty. We understand the law in regard to the liability of the principal and the agent to third persons for torts occurring in the course of agency to be this: The principal is always liable to third persons for misfeasance, negligence and omissions of duty, with his agent, in all cases within the scope of his agency. The agent is always liable to third persons for his own misfeasances and omissions of duty in the course of his employment, which liability in this latter case is solely to his principal, and hence, the general maxim as to all negligence and omission of duty is, in case of private agencies, *respondeat superior*.¹⁶²

"A servant as between himself and his master is bound to serve with fidelity, and to perform the duties committed to him. The omission to perform them may subject third persons to harm, and the master to damages, but the breach of a contract of service is a matter

¹⁵⁸ Seale v. Baker, 70 Tex. 283, 7 S. W. 742, 8 Am. St. Rep. 592; Delano v. Case, 121 Ill. 247, 12 N. E. 676, 2 Am. St. Rep. 81; Kroeger v. Pitcairn, 101 Pa. St. 311, 47 Am. Rep. 718.

¹⁵⁹ Huntington v. Attrill, 118 N. Y. 365, 23 N. E. 544.

¹⁶⁰ Wright v. Wilcox, 19 Wend. 343, 32 Am. Dec. 507.

¹⁶¹ Peck v. Cooper, 112 Ill. 192, 54 Am. Rep. 231; Baker v. Wasson, 53 Texas, 150.

¹⁶² Henshaw v. Noble, 7 Ohio St. 226.

between the master and servant alone and the non-feasance of the servant causing the injury to third persons is not generally at least a ground for civil action against the servant in their favor."¹⁶³

It is to be noted here as we already have suggested that the servant is liable to his master for misfeasance and other wrongful acts. So too it is settled that officers must account for secret profits, and this is true notwithstanding such profits may have been divided among a part of the directors of the corporation.¹⁶⁴ Some of the courts make a distinction where the officer is serving without pay or salary, and liken his liability under such circumstances to that of a gratuitous bailee. This is very doubtful law.

"The salary or compensation of corporate officers is usually fixed by a by-law or by a resolution either of the directors or stockholders, but where no salary has been fixed, none can be recovered. Corporate offices are usually filled by the chief promoters of the corporation, whose interests in the stock or in other incidental advantages is supposed to be a motive for executing the duties of the office without compensation, and this presumption prevails until overcome by an express prearrangement of salary. Hence, it is held in *Loan Assn. v. Stonemet*, 29 Pa. St. 534, as a general principle, that a director of a corporation, elected to serve without compensation, could not recover in an action against the company for services rendered in that capacity, though a subsequent resolution of the board, agreeing to pay him for past services, was shown. * * * And the rule is just as applicable to presidents and treasurers and other officers as to di-

¹⁶³ *Murray v. Usher*, 117 N. Y. 542.

¹⁶⁴ *Rutland Elec. Light Co. v. Bates*, 68 Vt. 579, 35 Atl. 480, 54 Am. St. Rep. 904; *Ore. Gold Min. Co. v. Schmidt* (Ky.), 60 S. W. 530.

rectors * * * It is well that the law is so. Corporate officers have ample opportunities to adjust and fix their compensation before they render their services, and no great mischief is likely to result from compelling them to do so. But if, on the other hand, actions are to be maintained by corporate officers for services, which, however faithful and valuable, were not rendered on the foot of an express contract, there would be no limitation to corporate liabilities, and stockholders would be devoured by officers."¹⁶⁵

This decision unquestionably lays down the correct rule of law and has been recognized in nearly every jurisdiction of the United States.¹⁶⁶ That such officers cannot recover on *quantum meruit* for ordinary services performed, as such officers, is also believed to be well settled law.¹⁶⁷

"It is elementary law that an officer of a corporation

¹⁶⁵ Kilpatrick v. Penrose Bridge Co., 49 Pa. St. 118, 88 Am. Dec. 497.

¹⁶⁶ McConnell v. Com. Min., etc. Co., 30 Mont. 239, 76 Pac. 195, 104 Am. St. Rep. 703; Brown v. Republican Mt. Silver Mines, 17 Colo. 421, 30 Pac. 66; Curtin v. Salmon R., etc. Co., 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; Brown v. Valley View Min. Co., 127 Cal. 630, 60 Pac. 424; Camden Land Co. v. Lewis, 101 Me. 78, 63 Atl. 523; Crumlish v. Central Imp. Co., 38 W. Va. 390, 18 S. E. 456, 23 L. R. A. 120, 45 Am. St. Rep. 872; Martindale v. Wilson-Cass Co., 134 Pa. St. 348, 19 Atl. 680, 19 Am. St. Rep. 706; St. Louis R. R. Co. v. O'Hara, 52 N. E. 734; Burns v. Commencement Bay Co., 4 Wash. 558, 30 Pac. 668; Lowe v. Ring, 123 Wis. 370, 101 N. W. 698, 3 A. & E. Ann. Cas. 731; Monmouth Inv. Co. v. Means, 151 Fed. 159; Althouse v. Cobaugh, etc. Co., 227 Pa. 580, 76 Atl. 316, 136 Am. St. Rep. 908; Boothe v. Summit Coal Min. Co., 55 Wash. 167, 104 Pac. 207; Stout v. Security, etc. Co., 81 N. Y. S. 708; Richie v. People's Tel. Co., 22 S. D. 598, 119 N. W. 990.

¹⁶⁷ Gridley v. Lafayette Ry. Co., 71 Ill. 200; Cheeney v. Lafayette Ry. Co., 68 Ill. 570, 18 Am. Rep. 264; Citizens Natl. Bank v. Elliott, 55 Iowa, 104, 7 N. W. 470, 89 Am. Rep. 167; Crumlish v. Central Imp. Co., 38 W. Va. 390, 18 S. E. 456, 23 L. R. A. 120, 45 Am. St. Rep. 872; Lowe v. Ring, 123 Wis. 370, 101 N. W. 698, 3 A. & E. Ann. Cas. 731.

while acting as a director cannot fix his own salary so as to bind the corporation in an action by it or by a nonconsenting stockholder in its name challenging the validity of the salary."¹⁶⁸ Therefore, an attempt of the board of directors to grant to one of their number who is also an officer of the company a salary is void, or at least voidable when the vote of the interested officer was necessary to the passage of the resolution.¹⁶⁹

So too the law is well settled that directors of the corporation cannot vote a salary to one of their number as president, or secretary, or treasurer, at a meeting where his presence is necessary to a quorum.¹⁷⁰ Indeed, the weight of authority is to the effect that a majority of a quorum of the board of directors of the

¹⁶⁸ *Figge v. Bergenthal*, 130 Wis. 594, 109 N. W. 581, 110 N. W. 798.

¹⁶⁹ *Martin v. Santa Cruz, etc. Co.*, 4 Ariz. 171, 36 Pac. 36; *Curtin v. Salmon River, etc. Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *Steele v. Gold Fisher Min. Co.*, 42 Colo. 529, 95 Pac. 349, 126 Am. St. Rep. 177; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203; *Beach v. Miller*, 130 Ill. 162, 22 N. E. 464, 17 Am. St. Rep. 291; *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 523; *Miner v. Belle Ice Co.*, 93 Mich. 97, 53 N. W. 218; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Tausig v. St. Louis, etc. Ry. Co.*, 166 Mo. 28, 65 S. W. 969, 89 Am. St. Rep. 674; *McConnell v. Com. Min., etc. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703; *Van Hook v. Sommerville Co.*, 5 N. J. E. 137; *Butts v. Wood*, 37 N. Y. 317; *Fitchett v. Murphy et al.*, 61 N. Y. S. 182; *Hardee v. Sunset Oil Co.*, 56 Fed. 54; *Parson v. Tacoma Smeltering, etc., Co.*, 25 Wash. 492, 63 Pac. 765; *Boothe v. Summit Coal Min. Co.*, 55 Wash. 167, 104 Pac. 207; *Figge v. Bergenthal*, 130 Wis. 594, 109 N. W. 581, 110 N. W. 798.

¹⁷⁰ *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 524; *Curtin v. Salmon River Co.*, 130 Cal. 345, 62 Pac. 552, 80 Am. St. Rep. 132; *Wheelright v. St. Louis Co.*, 56 Fed. 164; *Kelly v. Newburyport Co.*, 6 N. E. 745; *Barnes v. Brown*, 80 N. Y. 527; *Jones v. Morrison*, 31 Minn. 140, 16 N. W. 854; *Van Hook v. Sommerville Co.*, 5 N. J. E. 137; *Beach v. Miller*, 130 Ill. 162, 22 N. E. 464; *Parson v. Tacoma Smelting, etc. Co.*, 25 Wash. 492, 67 Pac. 765. *Contra*: *Francis v. Brigham-Hopkins Co. (Md.)*, 70 Atl. 95; *Buell v. Buckingham*, 16 Iowa, 284, 85 Am. Dec. 516.

corporation must be disinterested in the subject matter of the resolution voted on to make it valid and binding on the corporation. Hence, where two or three directors of a corporation are officers whose salaries are fixed in a single resolution, they are both disqualified and can not be counted to make a quorum and to pass the resolution.¹⁷¹

In the case last cited, five of the six trustees of the corporation were present at the meeting, four of the six, being a majority, voting in favor of each resolution, but no one of the trustees voting for the resolution by which he himself was benefited. The supreme court of New York commenting on a resolution passed in this manner, after holding the resolution illegal, has the following to say:

“The unanimity with which they were accepted is consistent with no other view of the facts than that it had been arranged before the resolutions were proposed that they should be proposed and adopted in favor of each one of the five trustees in this manner, and that each of the four trustees voted for the resolution in favor of the other trustee upon the understanding that a similar vote was to be given upon each resolution providing for the salary of each of the other trustees.”¹⁷²

Where separate resolutions were introduced and passed, the supreme court in *Fitchett v. Murphy, et al.*, *supra*, has the following: “At the same meeting three separate resolutions were passed fixing salaries for all the directors. (The salaries fixed in this were the salaries of the president, vice-president, secretary and manager who were also members of the

¹⁷¹ *Steele v. Gold Flissure Min. Co.*, 42 Colo. 529, 95 Pac. 349, 126 Am. St. Rep. 177; *Fitchett v. Murphy et al.*, 61 N. Y. S. 182.

¹⁷² *McNabb v. McNabb, etc. Mfg. Co.*, 62 Hun, 18, 16 N. Y. S. 448. See, also, *Schaffhauser v. Arnholt, etc. Brewing Co.*, 218 Pa. St. 298, 67 Atl. 417, 11 A. & E. Ann. Cas. 776.

board of directors and the officers referred to by the court under the name of 'directors'). That each one refrained from voting on the resolution fixing the salary does not change this case. Too much importance is attached to that generally. Wool is not so easily pulled over the eyes of the law. All was done under the same arrangement."

It would seem from the authorities that where the directors by concerted action vote compensation to one of their number as president, vice-president, or secretary, or treasurer, although the interested director abstains from voting on such resolution, it will be declared invalid by the courts, unless there is a clear majority of the board of directors present who are not interested in the passage of the resolution, or similar resolutions passed at the same meeting giving to the balance of the directors as officers similar allowances. We have examined in this connection the comments made by the supreme court of Colorado as follows:

"We think this case is clearly opposed to the weight of authority, and clearly contrary to the universal doctrine that a director who is disqualified by reason of personal interests in the matter before a director's meeting loses his character as a director, and cannot be counted for the purpose of making it a quorum; nor can his vote be counted for the purpose of determining whether a resolution has been passed by a majority vote. Under this rule it seems clear that, when a director has a direct personal interest in the passage of a resolution, he is disqualified from voting upon it for all purposes." The supreme court of Missouri does not agree with this rule.¹⁷³

It has been held that where the records of the corporation show that the officer to whom compensation was voted was present at the meeting of the board of directors when the vote was taken therein, it will be

¹⁷³ *Funsten v. Funsten Commission Co.*, 67 Mo. App. 559.

presumed that he voted for the resolution authorizing his salary or compensation.¹⁷⁴ Of course where the records show that he was present and also show that the resolution was passed by unanimous vote, the presumption will be that the record is correct and that he voted for the adoption of the resolution.¹⁷⁵

It is to be noted, in passing, that all of the cases cited involve the question of the relation of the directors to the corporation. Where the officer, to whom the salary has been voted was not a director, a different rule applies. The supreme court of Illinois says: "Where the office of treasurer, secretary or attorney, etc., is held by a mere stockholder, or other person not connected with the directory, the rule should not apply, as they are wholly disconnected from the management and disposal of the property, and are not tempted to misapply the funds, or when they perform duties disconnected from their office, and no rule of public policy is thereby violated."¹⁷⁶

While a number of courts hold that the action of officers, voting themselves salaries, is absolutely void,¹⁷⁷ yet the weight of authority seems to be that the corporation may ratify and validate such proceedings, and, when properly ratified, are binding upon the corporation.¹⁷⁸ Thus a resolution of a board of directors, fixing the salary of the president, but illegal, because it required the president's vote to adopt it, could be

¹⁷⁴ *Ravenswood, etc. Co. v. Woodyard*, 46 W. Va. 558, 33 S. E. 285.
Contra: Zellerbach v. Allenberge, 99 Cal. 57, 33 Pac. 786.

¹⁷⁵ *Keans v. N. Y., etc. Co.*, 40 N. Y. S. 366.

¹⁷⁶ *Holder v. Lafayette, etc. Co.*, 71 Ill. 106, 22 Am. Rep. 89.

¹⁷⁷ *Hardee v. Sunset Oil Co.*, 56 Fed. 51; *Miner v. Belle Isle Ice Co.*, 93 Mich. 97, 53 N. W. 218.

¹⁷⁸ *Figge v. Bergenthal*, 130 Wis. 594, 109 N. W. 581; *Wickersham v. Crittenden*, 110 Cal. 332, 42 Pac. 893.

ratified by a subsequent board, so as to justify the president for having drawn such salary.¹⁷⁹

The supreme court of Illinois has held that the same men, sitting merely as temporary stockholders of a corporation, to approve what they have done as directors thereof, are not *bona fide* stockholders for the purpose of ratifying an unauthorized act of the directors.¹⁸⁰

Where an officer performs services for the corporation, outside of his regular duties as such officer, he is entitled to compensation for such services, the same as any other agent of the corporation would be. It must be said, however, that the services, although of an extraordinary character, must be clearly and unquestionably beyond his official duties.¹⁸¹

From examination of the authorities that we have cited on the question of compensation to corporate officers, it readily will be seen that if the corporation desires to avoid litigation, trouble and misunderstanding, it will first provide in the by-laws that the compensation of all officers and agents of the corporation shall be fixed and determined by the board of directors, and then, immediately upon the election of such officers, and the appointment of its agents, have the board of directors fix such compensation as is reasonable and

¹⁷⁹ *Martin v. Santa Cruz, etc. Co.*, 4 Ariz. 171, 36 Pac. 36; *Pomeroy Equity Jur.*, sec. 964.

¹⁸⁰ *McNulta v. Corn B. Bank*, 164 Ill. 427, 45 N. E. 954, 56 Am. St. Rep. 203.

¹⁸¹ *Burns v. Commencement Bay Co.*, 4 Wash. 558, 30 Pac. 668; *Brown v. Valley View Min. Co.*, 127 Cal. 630, 60 Pac. 424; *Brown v. Republican, etc. Mines*, 17 Colo. 421, 30 Pac. 66, 16 L. R. A. 426; *Ruby Chief Min. Co. v. Prentice*, 25 Colo. 4, 52 Pac. 210; *Cheaney v. La Fayette, etc. Co.*, 68 Ill. 570, 18 Am. Rep. 584; *Felton v. W. Iron Mt. Min. Co.*, 16 Mont. 81, 40 Pac. 70; *Severson v. Bi-Metallic Ext. Min. Co.*, 18 Mont. 13, 44 Pac. 79; *Santa Clara Min. Ass'n v. Meredith*, 49 Md. 389, 83 Am. Rep. 264; *Graves v. Mono Lake Hy. Min. Co.*, 81 Cal. 303, 22 Pac. 665.

just, in accordance with the terms of such by-law provision. This suggestion applies only where a majority of the board of directors are in no way connected with the officers of the company. For, as we have suggested, unless a majority of the board of directors have no interest in the fixing and granting of the compensation, it would be difficult to so arrange it that such compensation might be lawfully fixed and paid.

Where the board of directors is small in number, or the officers are selected from among the directors to such an extent that a majority of the directors are also officers of the company, it will be necessary to either fix their compensation by the by-laws, or at the annual meeting of the stockholders.

It should be distinctly understood that the courts are not adverse to paying salaries to corporate officers, nor are they adverse to paying reasonable and just compensation in all cases for services performed by such officers, but the innumerable frauds which creep through this door, and which are constantly practiced upon the stockholders, have prompted the courts to lay down certain rules and regulations, deemed necessary for the proper protection of the stockholders and creditors of the corporation.

President. The president shall preside over all meetings of the stockholders and directors; he shall sign, as president, all certificates of stock, and all contracts and other instruments in writing, which have been approved by the board of directors; he shall submit to each annual stockholders' meeting a full and complete report and statement of the affairs of the corporation; he shall make from time to time such reports to the board of directors concerning the business affairs of the corporation as shall be requested of him by such directors; he shall call the directors together when-

ever he deems it necessary, and shall have, subject to the power and authority of the directors, the direction of the affairs of the corporation, and, generally, shall discharge such other duties as may be required of him by the laws of the state, the charter of the corporation and these by-laws.

The president of a corporation, being recognized as the chief executive officer should not only be familiar with the general nature of the corporate business and the interests of the company, but should be thoroughly competent from the standpoint of carrying out the purposes for which the corporation is organized. In the large industrial corporations and many of the railroad companies a chairman of the board of directors is provided for. He is usually made the executive head of the corporation and presides at all meetings of the stockholders and of the board of directors. In the average corporation this is an unnecessary office. In the absence of a chairman of the board of directors the president will be the highest officer of the company, and subordinate only to the power and orders of the board of directors. It should always be his duty to direct the corporate affairs and assume complete control of its business at all times during the absence of the board, except where the by-laws provide for an executive committee. Where an executive committee is provided for, the president should be chairman of the committee and preside at its meetings. He should keep in close touch with every corporate act of the board and committee. It is needless to suggest that the president always should be a member of the board of directors.

While the president is recognized as the executive officer of the corporation, and while he is generally looked upon to formulate its plans, they should never

be carried out by him without authority from the board of directors.

The president by virtue of his office possesses very little or no authority to act for or bind the corporation;¹⁸² therefore, the powers of the president must come, first, from the by-laws, and, second, from the board of directors. He possesses no inherent power to contract for the corporation;¹⁸³ nor has he inherent power to purchase property for the corporation;¹⁸⁴ nor has he power or authority to sell the corporate property;¹⁸⁵ nor to borrow money or make or execute notes, bonds, or other evidences of indebtedness;¹⁸⁶ nor has he authority to endorse notes;¹⁸⁷ nor make an assignment for the benefit of creditors;¹⁸⁸ nor consent to the appointment of a receiver;¹⁸⁹ nor extend the date of collateral security.¹⁹⁰ In short he has no authority, by virtue of his office, to make contracts out-

¹⁸² *Groeltz v. Armstrong, etc. Co.*, 89 N. W. 21; *National St. Bank v. Vigo Co. Natl. Bank*, 141 Ind. 352, 40 N. E. 799, 50 Am. St. Rep. 330; *Mausert v. Christian Feigenspan*, 68 N. J. E. 671, 63 Atl. 610; *Glenn v. Bear River, etc. Co.*, 20 Cal. 602, 81 Am. Dec. 132; *Mount Sterling, etc. Co. v. Looney*, 1 Met. (Ky.) 550, 71 Am. Dec. 491; *Minn. Lumber Co. v. Hobbs*, 122 Ga. 20, 49 S. E. 783; *Cogan v. Conover Mfg. Co. (N. J. E.)*, 60 Atl. 408; *Demarest v. Spiral Rivetted Tube Co. (N. J.)*, 58 Atl. 161; *Cushman v. Clover Land, etc. Co.*, 170 Ind. 402, 84 N. E. 759, 127 Am. St. Rep. 391.

¹⁸³ *Minn. Lumber Co. v. Hobbs*, *supra*.

¹⁸⁴ *Glenn v. Bear River, etc. Co.*, *supra*; *Bliss v. Kaweah Canal Co.*, 65 Cal. 502, 4 Pac. 507.

¹⁸⁵ *N. W. Packing Co. v. Whitney*, 5 Cal. App. 105, 89 Pac. 981; *Ansley Land Co. v. Western Lbr. Co.*, 152 Fed. 841; *Bliss v. Kaweah, etc. Co.*, 65 Cal. 502, 4 Pac. 507.

¹⁸⁶ *City Electric, etc. Co. v. First Nat. Ex. Bank*, 62 Ark. 33, 54 Am. St. Rep. 282; *Nat. Bank of Com. v. Atkinson*, 55 Fed. 465.

¹⁸⁷ 21 Am. & Eng. Enc. of Law, 860.

¹⁸⁸ *Friedman v. Leshner*, 198 Ill. 21, 64 N. E. 736, 92 Am. St. Rep. 255; *Calumet Paper Co. v. Haskett, etc. Print. Co.*, 144 Mo. 331, 45 S. W. 1115, 66 Am. St. Rep. 425.

¹⁸⁹ *Saxon v. S. W. Brick, etc. Co.*, 113 La. 637, 37 South. 540.

¹⁹⁰ *Bank v. Am. Exch. Bank*, 125 Fed. 518.

side of the general course of his duties as prescribed in the by-laws.

Indeed much authority can be found to the effect that: "The president of the board of trustees of a corporation, in the absence of express or implied power, has no more authority to bind the corporation than any other individual trustee."¹⁹¹ However this rule can hardly be said to be good law, and it is not sustained by the weight of authority. The better and more equitable rule, and the one which is sustained by the great weight of authority, is that the president of a corporation may perform any and all acts: "Of an ordinary nature, which, by usage or necessity, are incidental to his office, and may bind the corporation by contracts in matters arising in the usual course of business."¹⁹² And, "Where a contract made in the name of a corporation by its president is one the corporation has power to authorize its president to make, or to ratify, after it has been made, the burden is upon the corporation, of showing that it was not authorized nor ratified."¹⁹³

In other words, if a contract is one that the corporation has power to make, it is not necessary that an affirmative showing be made to the effect that the president was first authorized by the board of directors to make the contract in question, but the acts of the president relating to the corporate business will be pre-

¹⁹¹ *Lyndon Mill Co. v. Lyndon Lit. & Bib. Inst.*, 63 Vt. 581, 22 Atl. 575, 25 Am. St. Rep. 783; see, also, *Fairfield Sav. Bank v. Chase*, 72 Me. 226, 39 Am. Rep. 319.

¹⁹² *Sparks v. Dispatch Trans. Co.*, 104 Mo. 531, 15 S. W. 417, 24 Am. St. Rep. 351, 12 L. R. A. 714; *Mitchell v. Deeds*, 49 Ill. 416, 95 Am. Dec. 621; *Chicago, etc. Ry. Co. v. Colman*, 18 Ill. 297, 68 Am. Dec. 544; *Ceeder v. Loud*, 86 Mich. 541, 49 N. W. 575, 24 Am. St. Rep. 134.

¹⁹³ *Cook on Corporations*, page 1772 (note).

sumed to be legal until it is otherwise established.¹⁹⁴ This, says the supreme court of Washington, is probably an extension of the general and older rule. That court, however, takes the position that such an extension is necessary to prevent great hardships being cast upon those who deal with corporations.¹⁹⁵

It would seem that the rule announced by the authorities above noted is the proper and better view to be taken. To hold that one dealing with a person holding himself out as the president of a corporation must, before he can hold the company liable for contracts made in its name, have the duly elected president show affirmatively that the corporation properly authorized the making of such contract will often result in great hardship, as it is often difficult to show affirmative authority, notwithstanding the fact that it might exist.

In many corporations operating on the Pacific Coast, the books are very improperly kept, and sometimes no records are kept of resolutions and acts of the board of directors, although made and acted upon in proper form. It should not be forgotten that the records of the board of directors need not necessarily be in writing, therefore, it seems that the better rule is to hold that the acts of the president of a corporation are *prima facie* those of the company, but that such presumption may be rebutted, on affirmative proof on the part of the corporation that the act was never authorized by such corporation. If the act was never authorized, it is a very easy matter for the corporation to bring its books and records into court and show this affirmatively.

It is impossible to discuss the powers of the presi-

¹⁹⁴ Sun Print. Ass'n v. Moore, 183 U. S. 642, 46 L. Ed. 366; Burkamp v. Healey (Ky.), 72 S. W. 759; Carrigan v. Imp. Co., 6 Wash. 590, 34 Pac. 148.

¹⁹⁵ Carrigan v. Imp. Co., *supra*.

dent, or in fact, any other officer of the corporation, without taking into consideration the doctrine of estoppel. This doctrine has, in many respects, kept pace with the rapid growth and remarkable development of corporate enterprise. The modern rule is well and aptly stated by Justice Marshall of the supreme court of Wisconsin in this language:

“As has often been said, intolerable mischief would result from requiring every person, at his peril, in dealing with the president of a corporation in a matter outside the scope of his duties as such, to first examine its records. The business world is not subject to any such dangers. The application of the doctrine of estoppel has kept pace with the rapid development of corporate enterprise, so that, while ancient rules regarding limits upon powers of officers of corporations have not been abrogated, they are conclusively presumed to have been complied with, or compliance to have been waived by the corporation, where justice so requires.”¹⁹⁸

This is a proper and just rule protecting alike the corporation and persons dealing with it. In other words, where the corporation allows an officer in charge of its business affairs to so conduct himself in his dealing and transactions on behalf of the corporation as to lead persons with whom he deals to believe that he possesses certain powers, or where, by established and universal custom, such person has been permitted to enter into like contracts, the corporation will not be allowed to question such authority, as against one relying upon such custom when making the contract. This is especially true where the corporation accepts, or retains the benefits of the contract.

¹⁹⁸ St. Clair v. Rutledge, 115 Wis. 583, 92 N. W. 234, 95 Am. St. Rep. 964.

Thus, "The authority of the president of a corporation to do the act in question need not appear by the record, or by formal vote or resolution, but may be implied from acquiescence and from the nature and course of business transacted by the corporation, as where the doing of the act was known to the directors, and no objection was made to it at any time, and the president had been in the habit of exercising extraordinary powers."¹⁹⁷ "One dealing with the president of a corporation, in the usual course of business, and within the powers which he has been accustomed to exercise without objection from the directors, has the right to assume that he has been invested with those powers"¹⁹⁸ "In an action upon a note of a corporation signed in its name by its president and secretary, but for which there was no express authorization of the company, the company is estopped from asserting that the officers acted outside of their authority, when all the business of the company, including the making of numerous notes of the kind in question had been for a long time transacted by said officers, and informally ratified by the company by its action in paying the same, no fault ever being found with the action of such officers in so conducting the business."¹⁹⁹

¹⁹⁷ *Ford v. Hill*, 92 Wis. 188, 66 N. W. 115, 53 Am. St. Rep. 902.

¹⁹⁸ *Nat. State Bank v. Vigo County Nat. Bank*, 141 Ind. 352, 40 N. E. 799, 50 Am. St. Rep. 330; *McKinley v. Mineral Hill Con. Min. Co.*, 46 Wash. 162, 89 Pac. 495; *Saunders v. United States Marble Co.*, 25 Wash. 475, 65 Pac. 782.

¹⁹⁹ *Duggan v. Pac. Boom Co.*, 6 Wash. 593, 34 Pac. 157, 36 Am. St. Rep. 182. See also, *McKinley Hill Con. Min. Co.*, 46 Wash. 162, 89 Pac. 495; *Anderson v. Wallace Lumber Co.*, 30 Wash. 147, 70 Pac. 247; *Nat. Bank of Com. v. Puget Sound Bisc. Co.*, 61 Wash. 192, 112 Pac. 265; *Winer v. Bank of Blytheville*, 89 Ark. 446, 117 S. W. 237; *Tyler Est. v. Hoffman* (Mo. App.), 124 S. W. 535; *Weissinger Tob. Co. v. Van Buren*, 135 Ky. 759, 123 S. W. 289; *Blake v. Domestic Mfg. Co.*, 64 N. J. E. 480, 38 Atl. 241.

It is never advisable for the board of directors to intrust the entire management of the business affairs of a corporation to its officers, or permit the officers to go on, from time to time, performing the functions of the directors. Such neglect on the part of the directors will often entangle the corporation and jeopardize its business interests. Once the custom becomes established of permitting the officers to make contracts on behalf of the corporation it will be an easy matter for the officers to bind the corporation in nearly every kind of a contract, within the scope of the corporate powers. This is particularly true of the President. Where the directors have habitually followed the practice of giving their separate approval to the acts of their agents, without formal action of the board, the corporation will be held liable.

Vice President. It shall be the duty of the vice president to preside at all meetings of the stockholders, or directors, in the absence or disability of the president. In case of the removal of the president from office, or of his death, resignation, or disability to discharge the duties of his office, the same shall devolve upon the vice president.

This office is provided that there might be a successor to the president in case of his death or resignation, and also to provide the corporation with an officer to act in case of inability or refusal of the president to act. It is almost a necessary office, by reason of the fact that the president might be temporarily absent or refuse to perform the duties incident to his office, in which event the corporation would be greatly inconvenienced and often placed in jeopardy.

In the larger corporations several vice presidents are provided for and succeed in the order of their rank. This is hardly advisable in ordinary industrial

or mercantile companies. The vice president should be selected from among the directors. Whenever it becomes necessary for the vice president to assume the duties of the president, then he is bound by the same laws, rules, and regulations as govern the president. He is entitled to, and possesses the same rights, powers and privileges as the president, when acting as such.²⁰⁰ Therefore, the acts of the vice president when within the scope of his powers and within the limits prescribed by the by-laws, are binding upon the corporation.

His compensation should always be fixed by the board of directors after he is elected to office, otherwise, he will be entitled to no compensation for any work connected with the discharge of his duties.

Secretary. It shall be the duty of the secretary to keep a record of the proceedings of the stockholders, the board of directors, and the executive committee; which record shall embrace the time and place of holding the meeting, whether regular or special, and if special, its object, how authorized, and a notice thereof. Also such records shall embrace every act done or ordered to be done; who were present and who were absent, and if requested by any director, member or stockholder, the time must be noted when he entered the meeting, or obtained leave of absence therefrom.

He shall keep the corporate seal of the corporation and the book of blank certificates of stock; fill up and countersign all certificates issued and

²⁰⁰ Bell v. Standard Q. S. Co., 146 Cal. 699, 81 Pac. 17; Vincent v. Soper Lbr. Co., 113 Ill. App. 463; Friedman v. Leasher, 198 Ill. 21, 64 N. E. 736, 92 Am. St. Rep. 255; Manley v. Mayer, 68 Kan. 377, 75 Pac. 550; Fernald v. Spokane, etc. Co., 31 Wash. 672, 72 Pac. 462; Pond v. Nat. M. & D. Co., 6 Kan. App. 718, 50 Pac. 973; Valley Lbr. Co. v. McGilvery (Idaho), 101 Pac. 95; Smith v. Smith, 62 Ill. 492; Jefferson Bank v. Chapman, etc. Co., 122 Tenn. 415, 123 S. W. 641.

make the corresponding entries in the margin of such book on such issuance, and shall affix the corporate seal to all papers requiring a seal. He shall keep a transfer book and stock ledger, showing the number of shares issued to, and transferred by, any stockholder, and the dates of such issuance and transfer.

He shall also keep a record of all stock; the names of the stockholders, or members, alphabetically arranged; assessments levied, paid, and unpaid; a statement of every sale or transfer of stock made; the date thereof; by and to whom made. He shall keep proper account books and discharge such other duties as belong to his office, and as are prescribed by the board of directors. He shall serve all notices required either by law, or the by-laws of the company, and in case of his absence, inability, or refusal, or neglect so to do, then such notices may be served by any person directed by the president or vice president of the company.

He shall also make reports to the stockholders, the board of directors, and the executive committee as they may from time to time request.

The secretary is an indispensable part of the corporate machinery. In many respects, this officer fills a very important position from the standpoint of the corporation. He will often be confronted with knotty and bothersome questions, some of which will be more or less important, so that he must at all times exercise the utmost care and caution in the discharge of his official duties. It may be said, generally, that he should never take sides in the disagreements that so often arise in the management of the corporate affairs; nor grant special privileges or favors to some of the stockholders, but he should at all times, and under all circumstances, endeavor to fill his office in such a man-

ner that the rights of all stockholders will be served alike.

His duties are usually quite fully set out and defined in the by-laws. It is right and proper that this should be done. He is the keeper of the corporate seal and the custodian of the corporate books and records. He records and keeps a journal of all the meetings of the stockholders, board of directors and executive committee. He also gives all notices required by law or the by-laws of the company to be given, such as a notice of the annual stockholders' meeting; notice of special meetings of the stockholders; notice to the directors of any and all meetings. It is his duty also to see that certain reports required by statute are filed with the proper state officials.

He has charge of the general correspondence, and generally, with the president, signs the stock certificates, corporate contracts, deeds, bills of sale, or other corporate instruments. In some states statutes exist requiring his signature to certain instruments. A few of the states now have statutory requirements as to what the records of the corporation shall contain. As it is necessary for the secretary to prepare and keep these records, it is proper that this subject should be noted here, e. g. The statute of Montana provides that:

"All corporations for profit are required to keep a record of all their business transactions; a journal of all meetings of their directors, members, or stockholders, with the time and place of holding the same, whether regular or special, and if special, its object, how authorized and the notice thereof given. The record must embrace every act done or ordered to be done; who were present, and who absent; and, if requested by any director, member, or stockholder, the time must be noted when he entered the meeting or ob-

tained leave of absence therefrom. On a similar request the ayes and noes must be taken on any proposition, and a record thereof made. On a similar request, the protest of any director, member or stockholder, to any action or proposed action must be entered in full; and such records must be open to the inspection of any director, member, stockholder or creditor of the corporation."

In addition to the records required to be kept by the preceding section, "Corporations for profit must keep a book, to be known as the 'Stock and Transfer Book' in which must be kept a record of all stock; the names of the stockholders, or members, alphabetically arranged; instalments paid or unpaid; assessments levied and paid or unpaid, a statement of every alienation, sale or transfer of stock made, the date thereof, and by and to whom: and all such other records as the by-laws prescribe."²⁰¹

California, Idaho and a number of other states have statutory provisions very similar to the one quoted from the state of Montana. The secretary possesses, by virtue of his office, no power or authority to make corporate contracts,²⁰² nor has he, authority to sell notes or other corporate property;²⁰³ nor borrow money;²⁰⁴ nor rent offices for the corporation; nor issue corporate stock, except in due course of his duties

²⁰¹ Political Code, sections 540 and 541.

²⁰² Cal. Wine-Mkrs. Corp. v. Sclaroni, 139 Cal. 277, 72 Pac. 990; Blood v. Marcuse, 38 Cal. 590, 99 Am. Dec. 435; Extension Gold Min. Co. v. Skinner, 28 Colo. 237, 64 Pac. 198; Farrell v. Gold Flint Min. Co., 32 Mont. 416, 80 Pac. 1027; Ross Oil & Gas Co. v. Eastman, 73 Kan. 464, 85 Pac. 531; Wolf v. Davenport, etc. Co., 93 Iowa, 218, 61 N. W. 847; Harris v. Congress Hall Hotel Co. (N. J.), 70 Atl. 330; Cobb v. Glenn Boom, etc. Co., 57 W. Va. 49, 49 S. E. 1005, 110 Am. St. Rep. 734.

²⁰³ Moroney v. Cole, 103 N. Y. Sup. 560; Cal. Wine-Mkrs. Corp. v. Sclaroni, *supra*.

²⁰⁴ Ala. Nat. Bank v. O'Neil, 128 Ala. 192, 29 South. 688.

as defined by the by-laws, or in compliance with orders received from the board of directors; nor has he power to sign drafts.²⁰⁵

In short, he is a mere servant, and, strictly speaking, has no power, except such as is incident to his duty as required by the by-laws or ordered by the board of directors. The fact that he also is a member of the board of directors does not increase his power as secretary.²⁰⁶

Like other servants of the corporation, he is to do what he is ordered by the board of directors, and perform the duties prescribed by the by-laws. While the secretary has no inherent power to make corporate contracts, yet, if the corporation accepts and retains the benefits of contracts made by the secretary, or where the corporation permits its secretary to conduct generally the business of the corporation, or ratifies other contracts he has made, the company may be estopped from denying his authority. The rule of law invoked is that: "The power of an agent or officer of a corporation to bind his principal is governed by the law of agency, and, where an officer has been permitted to manage all the business of the corporation, his power to bind it will be implied from the apparent power thus conferred upon him."²⁰⁷ Generally speaking, the secretary binds the corporation for torts committed within the scope of his corporate duties. Thus,

²⁰⁵ *Bank v. Hogan*, 147 Mo. 472.

²⁰⁶ *Farrell v. Gold Flint Min. Co.*, *supra*.

²⁰⁷ *Moore v. Gaus, etc. Co.*, 113 Mo. 98, 20 S. W. 975; see, also, *Blanc v. Germania Nat. Bank*, 114 La. 739, 38 South. 537; *Jones v. Williams*, 139 Mo. 1, 39 S. W. 486, 37 L. R. A. 682, 61 Am. St. Rep. 437; *Ford v. Hill*, 92 Wis. 188, 66 N. W. 115, 53 Am. St. Rep. 902; *Kocher v. Supreme Council*, 65 N. J. L. 649, 48 Atl. 544, 86 Am. St. 687; *St. Clair v. Rutledge*, 115 Wis. 583, 92 N. W. 234, 95 Am. St. Rep. 964; *McKinley v. Min. Hill Con. Min. Co.*, 46 Wash. 162, 89 Pac. 495.

where the secretary has wrongfully refused to transfer stock and issue new certificates to transferees entitled to the same, or where he refuses a stockholder the right to inspect the corporate records, or refuses to issue to persons stock to which they are justly entitled, the corporation is liable for his acts.

Like other corporate officers, he is bound to use and exercise, at all times, a reasonable degree of care and skill in the performance of his duties, and his acts must be free from any wrong doing. Where the secretary holds, in addition to the office of secretary, any other corporate office, then he is bound by the laws, rules and regulations applying to and governing both of such offices, and he possesses such powers and rights as are incident to both of such offices. Thus the secretary acting in the capacity of a general manager would possess the powers of a general manager, and would be under the same degree of responsibility as the general manager.²⁰⁸

What we have heretofore said regarding the salary of the president and other officers of the corporation applies with equal force to the secretary, and, if the secretary is either a stockholder or director of the company, he is entitled to no compensation for his services as secretary, unless, the governing statute, by-law regulation, resolution or contract, authorizes it prior to the rendition of, the service. The law does not imply an agreement to pay for such services, and, before he can recover, it is necessary for him to show an antecedent valid agreement to pay for such services. The law is well settled that, the secretary cannot recover upon *quantum meruit* for services rendered the corporation in the course of his duties as such.

²⁰⁸ Betts v. So. Cal. Fr. Exch., 144 Cal. 402, 77 Pac. 993.

It will be the duty of the secretary under the by-laws as suggested, and, indeed, it should be his duty without any by-law provision, to give all notices as required by the laws of the state under which the corporation is operating; such as, notices to the stockholders of their annual meeting, and notices to the directors, when required, of all meetings. He should see that the laws of the state under which the corporation is operating are fully complied with, and that all reports that are necessary to be filed under such laws, are filed in accordance therewith. The secretary will find it convenient to prepare for himself a corporate calendar on which he will have the dates of all necessary notices to be given, reports to be made, etc.

Treasurer. The treasurer of the corporation shall be the lawful custodian of the corporate funds and securities. He shall deposit all funds belonging to the corporation in the name of the corporation in such bank, or banks, as the board of directors shall elect. He shall sign all checks, drafts, notes and orders for the payment of money, and shall pay out and dispose of the same under the direction of the president or the board of directors, taking in all cases, proper vouchers for such disbursements. He shall at all reasonable times exhibit the books, records, accounts and vouchers to any director or stockholder of the company upon application of such person at the principal office of the corporation within business hours of any day, except Sunday and legal holidays. He shall execute a bond with good and sufficient securities, in such form and amount as shall be required by the board of directors, and do such other things incident to his office as shall be required by the board of directors.

The treasurer of all corporations is the legal custodian of the corporate funds. His chief duties and func-

tions are to properly care for such funds and pay out the same on order of the proper authority, usually the board of directors, or the president.²⁰⁹ Proper care and caution always should be exercised by the treasurer, that he has the proper authority for paying out the corporate funds, even to the extent of knowing that the order from the board of directors is within the powers vested in them.

He cannot pay out the money of the corporation in reckless disregard of the rights of the corporation, and where he has knowledge that the board of directors have wrongfully made the order, or palpably exceeded their authority in making the order, than he should refuse to honor the same. Otherwise, he might be liable to the corporation and its stockholders. He has no personal claim or title in or to the corporate funds.²¹⁰

Under no circumstances should the treasurer of the corporation intermingle the funds of the corporation with personal funds, but should deposit the corporate funds in some bank, or banks, in the corporate name. The treasurer possesses, by virtue of his office, little or no authority to make corporate contracts, or to bind the corporation.²¹¹

He has no authority to borrow money; ²¹² execute

²⁰⁹ *Albro M., etc. Co. v. Chinn*, 20 Colo. App. 238, 77 Pac. 1097; *Manhattan Webb Co. v. Aquidneck Nat. Bank*, 133 Fed. 76; *Baker v. U. S. Gas Co.*, 84 N. Y. S. 149.

²¹⁰ *Chapman v. Brewer*, 43 Neb. 890, 62 N. W. 320, 47 Am. St. Rep. 779; *Taylor v. Taylor*, 74 Me. 582.

²¹¹ *Dreeben v. First Nat. Bank (Tex.)*, 99 S. W. 850; *Clarkson Home v. Missouri, etc. Co. (N. Y.)*, 74 N. E. 571; *Albro M., etc. Co. v. Chinn*, *supra*; *Craft v. S. Boston, etc. Co.*, 150 Mass. 207, 22 N. E. 920, 5 L. R. A. 641; *Oak, etc. Co. v. Foster*, 7 N. M. 650, 41 Pac. 522; *Holden v. Upton*, 134 Mass. 177.

²¹² *Craft v. Boston, etc. Co.*, *supra*; *Jewett v. West Somerville, etc. Co.*, 173 Mass. 54, 52 N. E. 1085, 73 Am. St. Rep. 259.

notes for the corporation;²¹³ sign,²¹⁴ endorse,²¹⁵ or sell corporate mortgages;²¹⁶ give a release under seal;²¹⁷ or dispose of the corporate property. However, where the treasurer has been permitted to sign and endorse notes, or sell, or dispose of property, or in fact do anything within the powers of the corporation, and the board of directors have made no objection, but have permitted such acts to be ratified by acquiescence or otherwise, the corporation will be estopped to deny his authority.²¹⁸

Regarding the compensation of the treasurer, this officer, where he is either a director or stockholder, will be governed by the same rules that have heretofore been laid down regarding corporate officers, and he will not be allowed to take from the funds of the corporation, what he might claim for his salary, without express permission from the board of directors. The law is well settled that the treasurer, or other corporate officer, cannot apply the corporate property in his possession, to a debt due him from the corporation, without authority of the board of directors, and, where an attempt is made to carry out such a plan, the corporation may require a return of property thus appropriated.²¹⁹

²¹³ *Dreeben v. First Nat. Bank (Tex.)*, 99 S. W. 850.

²¹⁴ *Chem. Nat. Bank v. Wagner*, 93 Ky. 525, 20 S. W. 535, 40 Am. St. Rep. 206.

²¹⁵ *Bradlee v. Warren, etc. Bank*, 127 Mass. 107.

²¹⁶ *Dedham Inst. v. Slack*, 60 Mass. 408.

²¹⁷ *Jackson v. Campbell*, 5 Wend. 572.

²¹⁸ *Page v. Fall River, etc. Co.*, 31 Fed. 257; *Foster v. Ohio, etc. Co.*, 17 Fed. 130; *Moore v. Gaus Co.*, 113 Mo. 98, 20 S. W. 975; *Nashua v. Chandler*, 166 Mass. 419, 44 N. E. 348.

²¹⁹ *Camden Land Co. v. Lewis*, 101 Me. 78, 63 Atl. 523; *Emporium R. E. Co. v. Emrie*, 54 Ill. 345; *Greenville Gas Co. v. Reiss*, 54 Ohio St. 549, 44 N. E. 271.

General Manager. The general manager shall, under the supervision and control of the board of directors and the president, have charge of and manage the business operations of the company. He shall perform such further duties and make such reports as may be required of him by the board of directors, or the president, and shall receive such salary as may be fixed and determined by the board of directors.

Where the corporation has no managing director, the next important office both from a business and legal standpoint, aside from the president, is that of its general manager. As the term implies, he is the manager of the business operations of the company. Strictly speaking, he is not a corporate officer, although often so classed. He represents and binds the corporation in all matters falling within the scope of the powers conferred by the by-laws, which is the extent of his inherent powers.

Like the president, the general manager has certain recognized, implied powers.²²⁰ However, such implied powers are restricted to acts incident to the powers given either by the board of directors, or by-laws of the corporation. It is a common practice to elect one and the same person to the office of president and general manager. There is no serious objection to this practice. That he should be a man fully and thoroughly competent to take proper care of the business of the company, it is needless to suggest. His duties generally are and always should be, prescribed by the by-laws. His powers, aside from his inherent powers, depend upon the by-laws and the board of directors.

The powers of all corporate officers and agents de-

²²⁰ Hagerstown Brewing Co. v. Gates, 83 Atl. (Md.) 570; Fisk Mining Co. v. Reed, 32 Colo. 506, 77 Pac. 240; Carrigan v. Imp. Co., 6 Wash. 590, 34 Pac. 148.

pend very much upon the nature of the business of the corporation. This is especially true of the general manager of an industrial corporation. It may be said, generally, that he possesses no inherent power to sell or dispose of the corporate property, except in the regular course of business,²²¹ nor can he sign notes, bonds or other evidences of indebtedness, or act as a guarantor; nor employ men on long time contracts.²²² In mining corporations, contrary to the rule laid down in railroad corporations, a general manager cannot employ medical treatment for injured employees of the corporations;²²³ nor can he generally contract for the purchase of property for the corporation.

On the other hand, where the general manager of a corporation is intrusted with the management and control of all the business of the corporation, it has been held that his power may be extended to executing notes, mortgages and other evidences of indebtedness.²²⁴ So too, such general manager has implied power to borrow money necessary in the due course of business.²²⁵

Indeed authority can be found to the effect: "That in the absence of express restrictions on his powers, with actual or constructive notice thereof to the persons dealing with him, an officer or agent of the corporation intrusted with the general management and control of its business has implied authority to make

²²¹ *Reid v. Alaska Pkg. Co.*, 47 Ore. 215, 83 Pac. 139; *Hartford Iron Min. Co. v. Cambria Min. Co.*, 80 Mich. 890; *Schetter v. Southern Ore Co.*, 19 Ore. 192, 24 Pac. 25; *Butte & B. Con. Min. Co. v. Mont. Ore Pur. Co. (Mont.)*, 55 Pac. 112.

²²² *Reupke v. Stuhr, etc. Co.*, 126 Iowa, 632, 102 N. W. 509.

²²³ *Spellman v. Gold C. Min. Co.*, 26 Mont. 76, 66 Pac. 597, 91 Am. St. Rep. 402.

²²⁴ *Cit. Nat. Bank v. Wintler*, 14 Wash. 558, 45 Pac. 38, 53 Am. St. Rep. 890; *Carrigan v. Imp. Co.*, *supra*; *Cox v. Roblison*, 82 Fed. 277.

²²⁵ *Sun, etc. Ass'n v. Moore*, 183 U. S. 642, 46 L. Ed. 366.

any contract and do any other act which is necessary or appropriate in the ordinary business of the corporation." ²²⁶

Under this rule it has been held that the general manager has a right to collect debts due the corporation, and, where necessary, institute legal proceedings for the collection of such debts, and bind the corporation in all matters pertaining to such litigation. He has, of course, the right to employ such agents, clerks, servants and laborers, as are necessary to carry on the affairs of the corporation.²²⁷ He has also the right to employ an attorney and attend to the legal business of the corporation.

The general manager should make his reports to the president of the company unless the board of directors orders otherwise. While the general manager, as already suggested, undoubtedly has a large scope of implied powers, and where he is in full charge of the business affairs of the corporation and managing and conducting the same, and will properly bind the corporation in any contract within reason, yet, for the protection of such manager, and for the proper protection of the corporation, it is advised that all business transactions, affecting the property interests of the corporation, should be submitted to the board of directors, and their action had upon the same. We fully appreciate that the general manager of the average corporation, who sometimes fills the office of president also, is looked to by the stockholders of the corporation as

²²⁶ 3 Cur. Law, 916, citing, *Forked D. Pants Co. v. Shipley*, 25 Ky. L. R. 2299, 80 S. W. 476; *McKee v. Needles*, 123 Iowa, 195, 98 N. W. 618; *Pac. Nat. Bank v. Aetna Indem. Co.*, 33 Wash. 428, 74 Pac. 590; *Merchants & F. C. O. Co. v. Lufkin Nat. Bank* (Tex. Civ. App.), 79 S. W. 651; *Haggerty v. St. Louis, etc. R. Co.*, 100 Mo. App. 424, 74 S. W. 456.

²²⁷ *Vic. Gold Min. Co. v. Frazer*, 2 Colo. App. 14, 29 Pac. 667.

being the sole person responsible for the conduct of the business affairs of the company.

The board of directors, instead of managing the affairs of the corporation, as the by-laws usually require, often turns the whole enterprise over to the manager and allows him to run the affairs as best suits his judgment. However, this is neither advisable nor legal.

General Counsel. The general counsel shall be the legal advisor of the corporation; he shall, when requested by the board of directors, take part in their deliberations in an advisory capacity; he shall examine and prepare all documents, agreements and contracts for the corporation that may be referred to him by the board of directors; he shall represent the company in any and all litigation brought by or against it, and shall have authority to verify any and all pleadings for and on behalf of the company. He shall receive such retainer and compensation as shall be fixed and determined by the board of directors.

We recommend that the average corporation should retain a regular counsel, and not depend on hiring counsel after they are in litigation. It will be found that it is much more economical to employ regular counsel to keep the corporation from becoming involved in litigation than it will be to defend after it is in litigation.

The duties of the general counsel should be defined as fully as possible in the by-laws. He should have nothing to do with the management of the affairs of the corporation, for his services should be confined to advising and counselling with the officers and directors, and having charge of such litigation as may be conducted for or against the corporation. The board

of directors will find it advisable to have the advice of counsel in their meetings, whether regular or special.

The rapid and remarkable change from individual ownership of the great industries of the country to corporate ownership has probably affected the lawyer more than any other profession or class, and the counsel of an attorney in the directors' meetings, and in the method of outlining the business affairs of the company is more valuable than his services in the court room. This fact has made it necessary that attorneys specialize and qualify themselves especially for this kind of work.

The average corporation demands that its general counsel shall be a man experienced and learned in general corporation laws. The attorney representing the corporation is under the same degree of liability as if he were representing an individual. He has the same rights and powers as he would have were he employed and retained by an individual.

Auditor. It shall be the duty of the auditor of the company to examine, once every three months, all books, records, receipts, bills and vouchers on file in the office of the company, and report to the board of directors, within ten days after having made such examination, the correctness or incorrectness, and the general condition of all such books, records, receipts, bills and vouchers. It shall also be his duty to examine the financial condition of the corporation, its outstanding debts and obligations, and report the same, with such recommendations and suggestions as, in his judgment, seem right and proper. He shall also, at the annual meeting of the stockholders, submit his report of the condition of the corporation,

with such recommendations and suggestions as, in his judgment, are proper. He shall receive such compensation as the board of directors may determine.

The above by-law provision is self-explanatory. It simply provides the corporation with an officer who has authority to examine the books, records, vouchers, bills and receipts of the company, in order to ascertain its financial condition. The auditor, if the right and proper man is selected to fill the position, is an invaluable addition to the officers of the corporation, and, after a thorough study of all the conditions, will be able to make valuable recommendations and suggestions to the directors.

The auditor, under the by-law provision suggested, has no particular powers, except, he may demand that such books and records be given him, as he will require for his examination. He should always examine the books personally, and not be satisfied with a statement of the officers as to their condition.

In addition to the officers suggested, the corporation will sometimes find it advisable to appoint a purchasing agent, with power to purchase the supplies and incidentals for the company. The purchasing agent should never be recognized as an officer of the company, but should be hired from time to time, and be regarded as a simple agent. He should never be permitted to purchase property for the corporation, but his authority should be limited to purchasing supplies and incidentals.

A superintendent of works may also be appointed by the corporation, with such powers as the board of directors see fit to delegate. All these matters, however, must be governed by the discretion of the board of directors.

Resignation. All resignations of officers shall be in writing and filed with the secretary, and no officer shall be released from the liabilities of his office until such resignation has been acted upon and accepted by the board of directors.

We recognize the general rule to be that an officer of a corporation may resign at will, and the validity of such resignation does not depend upon its formal acceptance.²²⁸ In the absence of some rule in the charter or by-laws to the contrary, written resignation would not be necessary.²²⁹

²²⁸ *Manhattan v. Caldenberg*, 165 N. Y. 1, 58 N. E. 790; *Zeltner v. Zeltner Brew. Co.*, 174 N. Y. 247, 66 N. E. 810, 95 Am. St. 574.

²²⁹ *Briggs v. Spalding*, 141 U. S. 132, 35 L. Ed. 662; *Fearing v. Glen*, 73 Fed. 116.

SUNDRY PROVISIONS.

Corporate Books and Records. The corporate books and records, including stock books, stock transfer books and an alphabetical list of stockholders shall be kept at the principal place of business of the corporation as named in the articles of incorporation.

All such books and records shall be kept open to the inspection of any stockholder, member or creditor, who shall have a right to inspect and examine such books and records during the usual business hours of every day, except Sundays and legal holidays.

The above section of the by-laws is substantially a copy of the provisions of the statutes of the state of California. It is given here, and advised as a proper by-law provision under ordinary circumstances.

The law is unquestionably well settled that stockholders have a right to inspect and examine the books and records of the corporation, and the refusal to grant such permission will often involve the corporation in vexatious litigation. Therefore, it is believed better to plainly provide in the by-laws that it is the duty of the officers of the corporation to permit such examination. The damages in some cases resulting from the failure to permit such inspection will be fixed upon the officers violating this provision, instead of upon the corporation. The failure of the corporation to comply with the statutes of the various states regulating the manner and form in which the corporation records should be prepared, and with reference to the rights of the stockholders to make inspection thereof, will frequently subject the corporation to punishment,

and, in some cases, will impose a penalty both upon the corporation and its officers.

Generally speaking, the seal, stock, stock ledger and minute books, the list of stockholders and all other records of the corporation should be kept at the principal place of business of the corporation,²³⁰ unless special statutory permission is given by the state under whose laws the corporation is created to remove and keep such records outside the jurisdiction of such state.

It is believed, however, that even where such statutory authority is given, the place in which such records are kept must be reasonably accessible to the stockholders and creditors.

Corporate Seal. The seal of the corporation shall be of such form as the board of directors may adopt.

Under the common law of England a corporate seal was necessary. At the time Blackstone wrote his Commentaries it was indispensable. This idea was retained in some of the earlier decisions of this country. Under the common law it was necessary that the seal be impressed upon wax, wafer or some other tenacious substance. These old forms have long been discarded in the United States. The supreme court of Illinois in an early case said, "The old doctrine that corporations can only be bound by act under their corporate seal has been long exploded. They have become numerous, and their operations extending to almost every enterprise of the country, demanding such powers and facilities within their sphere of action as belong to natural persons in the prosecution of like enterprises,

²³⁰ *State v. P. & N. L. Co.*, 58 Minn. 330, 59 N. W. 1048, 49 Am. St. Rep. 516; *Simmons v. Norfolk & Balt. S. Co.*, 113 N. C. 147, 37 Am. St. Rep. 614, 18 S. E. 117, 22 L. R. A. 677; *State v. Milwaukee, etc. Ry. Co.*, 45 Wis. 579; *McConnell v. Comb. M. & M. Co.*, 30 Mont. 239, 76 Pac. 194, 104 Am. St. Rep. 703.

and, being intangible and invisible beings, created by the law, they can exercise them as natural persons only. Unless they may be bound in the ordinary affairs of the corporation by the acts and admissions of their officers, so far as relates to the business usually transacted through such officers, they would enjoy an immunity incompatible with the rights of individuals, and destructive of the objects of their creation.”²³¹

The statutes generally provide that every corporation, as such, has power to make and use a common seal, and alter the same at pleasure.

It is always advisable to affix the seal to all certificates and contracts, notwithstanding it may not be necessary. The reason is found in the fact that a corporate seal attached to an instrument signed by the secretary of the corporation must be presumed to be the seal of the corporation, and it must be presumed that the secretary sealed the instrument with the authority of the corporation; the secretary being under the law the custodian of the seal.²³²

Where the corporate seal is not affixed the authority of the officer must be proven.²³³

Dividends. Dividends shall be declared by the board of directors of the corporation from the surplus profits arising from the business thereof. The directors shall not make, declare or surrender dividends, except from the surplus profits; neither shall they divide, withdraw, or pay to the stockholders any part of the capital stock; or create debts beyond the subscribed capital stock of the corporation.

²³¹ Chicago, etc. R. R. Co. v. Coleman, 18 Ill. 299, 68 Am. Dec. 544.

²³² Bliss v. Harris, 38 Colo. 72, 87 Pac. 1076; Leggett v. N. J., etc. Co., 1 N. J. Eq. 541, 23 Am. Dec. 728; Morrison v. Wilder Gas. Co., 91 Me. 492, 40 Atl. 543, 64 Am. St. Rep. 257.

²³³ Allen v. Allston, 147 Ala. 609, 41 South. 159; Green & Co. v. Blodgett, 159 Ill. 169, 50 Am. St. Rep. 146. See generally: Cases from 50 Am. St. 146, and note.

For a violation of the provisions of this section the directors, under whose administration the same may have happened, excepting, of course, those who have caused their dissent therefrom to be entered in the minutes of the directors at the time, or were absent from such meeting, for good and sufficient cause, are, in their individual and private capacity, jointly and severally, liable to the corporation and the creditors thereof, in the event of its dissolution, to the full amount of the capital stock so divided, withdrawn, paid out or reduced, or debt contracted; and the statute of limitations is not a bar to any suit against such director, or directors. There may, however, be a division or distribution of the capital stock of the corporation remaining after the payment of all its debts upon its dissolution, or the expiration of its term of existence.²³⁴

We have heretofore called attention to the fact that incidental to the ownership of stock is the legal right to the dividends and earnings of the corporation. As soon as a dividend is declared and ordered, according to the statute, charter and by-laws, it belongs to the stockholders as a matter of right. It cannot be taken from them by any action of the board of directors. Until it is so declared, however, it belongs to the corporation, and the stockholders cannot, except where the directors wrongfully or fraudulently refuse to declare dividends, recover the same from the corporation.

There can be no question that dividends may be either cash, property, stock or bonds. They should in all cases, however, be declared and paid from the surplus profits or net earnings of the corporation. The

²³⁴ Goodnow v. American Writing Paper Co. (N. J.), 69 Atl. 1014.

by-law provision above not only requires that the dividends shall be declared and paid from the surplus and net profits of the corporation but in the event that an attempt is made to divide among the stockholders, stock that rightfully belongs to the corporation, or to declare dividends except from the surplus and net profits of the corporation, the board of directors will be liable for its debts.

Under the above by-law provision the declaring of dividends is left to the sound discretion of the board of directors and the courts will seldom interfere with this discretion unless there is some evidence of fraud or bad faith. Of course where an attempt is made to issue or pay out an illegal dividend or where the directors wrongfully and fraudulently withhold the declaring of a dividend when it should be declared, the courts will grant prompt relief to the stockholders.

The dividends, after they have been declared, should be paid to the record stockholders of the corporation. The corporation will always have the right to apply a dividend to the payment of any debt or claim owing by the stockholder to the company.

The substance of the above by-law provision has been enacted in the statutes of a number of the western states. This by-law provision prevents the directors from declaring dividends from any source other than the surplus profits of the corporation. It is recognized that often corporations will, for the purpose of creating a market for their stock and booming the corporation, declare and pay dividends out of the capital received for development purposes and before the corporation is actually on a dividend-paying basis. This is a practice which should never be tolerated by the management of a corporation.

Removal of Directors from Office. Directors who are unfaithful to their trust, or who shall fail, neglect or refuse to carry out the duties imposed upon them by the statutes of the state, the charter of the corporation and these by-laws, may be expelled and removed from office by the stockholders of the corporation. However no director shall be removed from office unless by a vote of the stockholders holding two thirds of the capital stock, at a meeting held after previous notice of the time and place and of the intention to propose such removal. Meetings of stockholders for this purpose may be called by the president or by a majority of the directors, or by members or stockholders holding at least one half of the entire outstanding capital stock of the corporation. Such calls shall be in writing and addressed to the secretary who shall thereupon give notice of the time, place and object of the meeting and by whose order it is called. If the secretary refuse to give the notice, or if there is none, the call may be addressed directly to the members or stockholders and be served as a notice of the regular annual meeting of stockholders, in which case it must specify the time and place of meeting. In case of removal the place shall be filled by the remaining directors.

The above by-law provision is proposed that the stockholders may, when a director proves unfaithful to his trust, or wilfully and negligently fails and refuses to carry out his duties to the corporation, remove such director from office. Should the stockholders determine to remove a director from office, care should be taken to comply with the by-law provisions of the corporation, also the statute of the state regulating such meetings. It is never advisable to remove a director from office if the annual meeting of the stockholders is near at hand. However there will occur from time

to time instances where there is no alternative for the stockholders but to remove a director.

A director should never be removed unless he is guilty of fraudulent conduct or wilful mismanagement. It is not right to remove a director simply because a majority of the stockholders do not agree with the business policy that is being pursued by him. Honest men will often differ as to the best plan or method of promoting a corporation, and simply because one man's judgment is different from another should be no ground for requiring a man to give up his directorship.

Reserve Fund. The board of directors, at their discretion, may set aside not to exceed \$10,000 of and from the surplus earnings of the corporation as a reserve fund.

It is often advisable where extension of the business is contemplated, such as increasing the capacity of plants, transportation facilities, etc., to create a reserve fund; that is a fund retained from the surplus earnings of the corporation that may be used by the corporation in the event of emergency. It is never advisable to declare all the surplus earnings of a corporation in dividends and surrender same to the stockholders, unless the corporation is on a safe financial basis, but it is better to retain part of the surplus as herein suggested.

Where the board of directors undertake from fraudulent or ulterior motives to reserve part of the surplus earnings of the corporation, courts will grant prompt relief to the stockholders, but where done in good faith, it will not be interfered with.

Amendments. These by-laws may be altered or amended at any meeting of the stockholders by a majority of the stock represented at such meet-

ing. The directors shall have a right, subject to the statute of the state, the charter of the corporation and the provisions of these by-laws to adopt additional by-laws in conformity herewith as may be necessary and proper for the purposes of the corporation, but they shall have no power to alter, repeal, or amend these by-laws, or any provisions herein contained.

Some states, among them Idaho, provide that the by-laws can be amended or repealed only at an annual meeting of the stockholders. In the absence of such statutes, they may be altered, amended or repealed at any properly called and held meeting. We have heretofore suggested that amendments proposed cannot interfere with nor abrogate the vested rights of the stockholders, nor be contrary to the governing statute, the common law, public policy, or good morals, and such amendments must also be legal, not retroactive, reasonable and adapted to the purposes of a corporation.

We also have suggested that often directors are given the right to adopt, amend and repeal the by-laws. However, this is believed to be inadvisable. The better and safer practice is to permit the directors to pass additional by-laws, not inconsistent with the laws of the state, charter of the corporation, or the by-laws already adopted by the stockholders. It may be found necessary and proper, to facilitate the business of the corporation, that such privilege be given to the board of directors, thus giving them an opportunity to meet any unforeseen emergency or contingency, and, at the same time, they are required to confine their acts within the bounds of reason and safety.

There is no denying the fact that if the directors are given unlimited authority to adopt, amend, and repeal the by-laws much abuse will follow. Thus, we say that

the stockholders themselves should make such changes in their by-laws as they desire.

Amendments to by-laws are usually submitted and passed upon at the annual meeting of the stockholders. Where a special meeting is called for the purpose of amending the by-laws, care must always be taken to see to it that the notice gives the proposed changes and amendments. While there is no question that the by-laws may be amended at the annual stockholders' meeting, the better practice where an amendment is contemplated is to call attention to this fact in the notice of the annual stockholders' meeting.

Reasonable amendments to the by-laws, which are made in accordance with the governing statute and charter of the corporation, will be binding upon members and stockholders of the corporation. They are also binding upon third persons who have actual notice of such amendments. Where third parties did not have actual notice of such amendments, of course, they would not be binding upon them.

Where an attempt is made to amend the by-laws, care should always be taken to follow the governing statute, the charter and the existing by-laws, as the corporation might be involved in litigation and trouble if an attempt were made to amend the by-laws, and a failure resulted by reason of not complying with the law.

FEDERAL CORPORATION TAX LAW.

History. We shall not attempt a thorough discussion of this law. Our observations shall be limited to the history, the status of the law and a review of the decisions construing it.

The law appears as paragraph 38 of the act of congress, approved August 5th, 1909, and is known as the "Corporation Tax Law." Congress had convened in extraordinary session to consider the revision of the tariff. The tariff bill originally introduced in the house of congress contained a plan of inheritance taxation. This bill was amended in the senate by practically substituting the present corporation tax for the inheritance tax suggested by the original bill.

In the well and carefully considered case of *Flint v. Stone Tracy Co.*, 220 U. S. 106, 55 L. Ed. 389, decided by the supreme court of the United States, March 13, 1911, the constitutionality of the act was determined and the law held constitutional. This case was argued March 17 and 18, 1910; ordered for reargument before a full bench May 31, 1910; reargued January 17, 18, and 19, 1911; decided March 13, 1911.

Who must pay—Amount of tax—Exemptions. Section 38. That every corporation, joint stock company or association, organized for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States or of any state or territory of the United States or under the acts of congress applicable to Alaska or the district of Columbia, or now or hereafter organized under the laws of any foreign country and engaged in business in any state or territory of the United States or in Alaska or in the dis-

trict of Columbia, shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation, joint stock company or association, or insurance company, equivalent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed; or if organized under the laws of any foreign country, upon the amount of net income over and above five thousand dollars received by it from business transacted and capital invested within the United States and its territories, Alaska, and the district of Columbia during such year, exclusive of amounts so received by it as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed: *Provided, however,* That nothing in this section contained shall apply to labor, agricultural or horticultural organizations, or to fraternal beneficiary societies, orders, or associations operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies orders or associations, and dependents of such members, nor to domestic building and loan associations, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

"It is at once apparent," says the supreme court, "that its terms" (referring to the above section), "embrace corporations and joint stock companies or

associations which are organized for profit, and have a capital stock represented by shares. Such joint stock companies, while differing somewhat from corporations, have many of their attributes and enjoy many of their privileges. To these are added insurance companies, and they, as corporations, joint stock companies, or associations, must be such as are now or hereafter organized under the laws of the United States or of any state or territory of the United States, or under the acts of congress applicable to Alaska and the district of Columbia."¹

However, a corporation organized for the purpose of owning and renting an office building, but which has wholly parted with the control and management of the property, and by the terms of a reorganization has disqualified itself from any activity in respect to it, its sole authority being to hold the title subject to a lease for 130 years, and to receive and distribute the rentals which may accrue under the terms of the lease, or the proceeds of any sale of the land, if it shall be sold, is not doing business within the meaning of the act.²

Again, real estate trusts created by deed for the purchasing, improving, holding, or selling lands and buildings for the benefit of the shareholders, which do not derive any benefit from and are not organized under, any statute of the state, and which, by their terms, end with lives in being and twenty years thereafter, are not subject to the provisions of this act.³

Insolvent corporations, with no net income, whose properties are being administered by a court are not subject to tax.^{3a}

¹ Flint v. Stone Tracy Co., supra.

² Zonne v. Minneapolis Syndicate, 220 U. S. 187, 55 L. Ed. 428.

³ Elliot v. Freeman, 220 U. S. 173, 55 L. Ed. 424.

^{3a} Penn. Steel Co. v. New York City Ry. Co., 176 Fed. 471.

It is to be noted that there is expressly excepted from the operation of the statute certain classes of corporations.

It has been held that the articles of incorporation are the sole criterion as to the intention of the incorporators.⁴

Under these decisions it seems clear that regardless of the intention of the incorporations, unless the articles of incorporation bring the corporation within the exception, it would come within the purview of this act.

Net income, how ascertained—Domestic corporations—Foreign corporations. Second. Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital

⁴ State v. Minn. etc. Co., 40 Minn. 213; Colgate v. U. S. Leather Co., 75 N. J. Eq. 229, 72 Atl. 126; Speer v. Colbert, 200 U. S. 130, 50 L. Ed. 403.

stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association or trust company, all interest actually paid by it within the year on deposits; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any state or territory thereof or imposed by the government of any foreign country as a condition to carry on business therein; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed: *Provided*, That in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, such net income shall be ascertained by deducting from the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the district of Columbia, (first) all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States and its territories, Alaska, and the district of Columbia, including all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year in business conducted by it within the United States or its territories, Alaska, or the district of Columbia not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law

to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness, not exceeding the proportion of its paid-up capital stock outstanding at the close of the year which the gross amount of its income for the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the district of Columbia bears to the gross amount of its income derived from all sources within and without the United States; (fourth) the sums paid by it within the year for taxes imposed under the authority of the United States or of any state or territory thereof; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, and insurance companies, subject to the tax hereby imposed. In the case of assessment insurance companies the actual deposit of sums with state or territorial officers, pursuant to law, as additions to guaranty or reserve funds shall be treated as being payments required by law to reserve funds.

The law expressly declares that the tax is to be equal to one (1) per centum of the entire net income over and above five thousand dollars (\$5,000), received from *all sources* during the year.

"The income, says the supreme court of the United States, is not limited to such as is received from property used in the business, strictly speaking, but is expressly declared to be upon the entire net income above \$5,000, from all sources, excluding the amounts received as dividends on stock in other corporations, joint stock companies or associations, or insurance companies also subject to the tax. In other words, the tax is imposed upon the doing of business of the character described, and the measure of the tax is to be the

income, with the deduction stated, received not only from property used in the business, but from every source."⁵

Deductions—When tax computed—When returns to be made, to whom, and where—Form to be prescribed by commissioner of internal revenue—What to contain. Third. There shall be deducted from the amount of the net income of each of such corporations, joint stock companies or associations, or insurance companies, ascertained as provided in the foregoing paragraphs of this section, the sum of five thousand dollars, and said tax shall be computed upon the remainder of said net income of such corporation, joint stock company or association, or insurance company, for the year ending December thirty-first, nineteen hundred and nine, and for each calendar year thereafter; and on or before the first day of March, nineteen hundred and ten, and the first day of March in each year thereafter, a true and accurate return under oath or affirmation of its president, vice-president, or other principal officer, and its treasurer or assistant treasurer, shall be made by each of the corporations, joint stock companies or associations, and insurance companies, subject to the tax imposed by this section, to the collector of internal revenue for the district in which such corporation, joint stock company or association, or insurance company has its principal place of business, or, in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, in the place where its principal business is carried on within the United States, in such form as the commissioner of internal revenue, with the approval of the secretary of the treasury, shall prescribe, setting forth (first) the total

⁵ Flint v. Stone Tracy Co., supra.

amount of the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year; (second) the total amount of the bonded and other indebtedness of such corporation, joint stock company or association, or insurance company at the close of the year; (third) the gross amount of the income of such corporation, joint stock company or association, or insurance company received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the district of Columbia; also the amount received by such corporation, joint stock company or association, or insurance company within the year by way of dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax imposed by this section; (fourth) the total amount of all the ordinary and necessary expenses actually paid out of earnings in the maintenance and operation of the business and properties of such corporation, joint stock company or association, or insurance company within the year, stating separately all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property, and if organized under the laws of a foreign country the amount so paid in the maintenance and operation of its business within the United States and its territories, Alaska, and the district of Columbia; (fifth) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in the case of insurance companies the sums other than dividends, paid within

the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; and in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, all losses actually sustained by it during the year in business conducted by it within the United States or its territories, Alaska, and the district of Columbia, not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve fund; (sixth) the amount of interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association, or trust company, stating separately all interest paid by it within the year on deposits; or in case of a corporation joint stock company or association, or insurance company, organized under the laws of a foreign country, interest so paid on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the district of Columbia, bears to the gross amount of its income derived from all sources within and without the United States; (seventh) the amount paid by it within the year for taxes imposed under the authority of the

United States or any state or territory thereof, and separately the amount so paid by it for taxes imposed by the government of any foreign country as a condition to carrying on business therein; (eighth) the net income of such corporation, joint stock company or association, or insurance company, after making the deductions in this section authorized. All such returns shall as received be transmitted forthwith by the collector to the commissioner of internal revenue.

Commissioner may require further information—May examine books and papers and summon witnesses—May invoke aid of courts—May amend return. Fourth. Whenever evidence shall be produced before the commissioner of internal revenue which in the opinion of the commissioner justifies the belief that the return made by any corporation, joint stock company or association, or insurance company is incorrect, or whenever any collector shall report to the commissioner of internal revenue that any corporation, joint stock company or association, or insurance company has failed to make a return as required by law, the commissioner of internal revenue may require from the corporation, joint stock company or association, or insurance company making such return, such further information with reference to its capital, income, losses, and expenditures as he may deem expedient; and the commissioner of internal revenue, for the purpose of ascertaining the correctness of such return or for the purpose of making a return where none has been made, is hereby authorized, by any regularly appointed revenue agent specially designated by him for that purpose, to examine any books and papers bearing upon the matters required to be included in the return of such corporation, joint stock company or association, or insurance company, and to require the attendance of any officer or employee of such corpora-

tion, joint stock company or association, or insurance company, and to take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons; and the commissioner of internal revenue may also invoke the aid of any court of the United States having jurisdiction to require the attendance of such officers or employees and the production of such books and papers. Upon the information so acquired the commissioner of internal revenue may amend any return or make a return where none has been made. All proceedings taken by the commissioner of internal revenue under the provisions of this section shall be subject to the approval of the secretary of the treasury.

Commissioner to make assessments—Penalty for fraudulent return or failure to make same; exception and extension to make—Penalty; assessment and collection of—Assessments; notification of; when payable; penalty for delinquency. Fifth. All returns shall be retained by the commissioner of internal revenue, who shall make assessments thereon; and in case of any return made with false or fraudulent intent, he shall add one hundred per centum of such tax, and in case of a refusal or neglect to make a return or to verify the same as aforesaid he shall add fifty per centum of such tax. In case of neglect occasioned by the sickness or absence of an officer of such corporation, joint stock company or association, or insurance company, required to make said return, or for other sufficient reason, the collector may allow such further time for making and delivering such return as he may deem necessary, not exceeding thirty days. The amount so added to the tax shall be collected at the same time and in the same manner as the tax originally assessed, unless the refusal, neglect, or falsity is discovered

after the date for payment of said taxes, in which case the amount so added shall be paid by the delinquent corporation, joint stock company or association, or insurance company, immediately upon notice given by the collector. All assessments shall be made and the several corporations, joint stock companies or associations, or insurance companies, shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the commissioner of internal revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as above provided for, and the assessment made by the commissioner of internal revenue thereon shall be paid by such corporation, joint stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due.

Assessment returns public record. Sixth. When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the commissioner of internal revenue and shall constitute public records and be open to inspection as such.

Unlawful to divulge information—Penalty. Seventh. It shall be unlawful for any collector, deputy

collector, agent, clerk, or other officer or employee of the United States to divulge or make known in any manner whatever not provided by law to any person any information obtained by him in the discharge of his official duty, or to divulge or make known in any manner not provided by law any document received, evidence taken, or report made under this section except upon the special direction of the president; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding one thousand dollars, or by imprisonment not exceeding one year, or both, at the discretion of the court.

Refusal or neglect to make return—Penalty—False or fraudulent return; penalty for—All laws applicable to tax extended—Jurisdiction of courts. Eighth. If any of the corporations, joint stock companies or associations, or insurance companies aforesaid, shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint stock company or association, or insurance company shall be liable to a penalty of not less than one thousand dollars and not exceeding ten thousand dollars.

Any person authorized by law to make, render, sign, or verify any return, who makes any false or fraudulent return, or statement, with intent to defeat or evade the assessment required by this section to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding one thousand dollars or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

All laws relating to the collection, remission, and refund of internal-revenue taxes, so far as applicable to and not inconsistent with the provisions of this sec-

tion, are hereby extended and made applicable to the tax imposed by this section.

Jurisdiction is hereby conferred upon the circuit and district courts of the United States for the district within which any person summoned under this section to appear to testify or to produce books as aforesaid, shall reside, to compel such attendance, production of books, and testimony by appropriate process.

Construction and regulations adopted by the commissioner of internal revenue, and approved by the secretary of the treasury.

ARTICLE 1.

The attention of collectors and others is specially called to the fact that the tax imposed by this section of the law applies to all corporations, joint-stock companies, associations, or insurance companies described (except those specifically exempted), without reference to the kind of business carried on, and that the tax is to be computed upon the NET INCOME of such corporations, joint-stock companies, associations, and insurance companies, which shall be calculated by subtracting from the gross income received from all sources during the year certain deductions specifically set forth in the statute.

Every corporation, joint-stock company, association, or insurance company not specifically enumerated as exempt shall make the return required by law, whether it may have net income liable to tax or not.

In the case of corporations, joint-stock companies, associations, or insurance companies organized under the authority of the United States or any state or territory thereof, including Alaska and district of Columbia, such net income relates not only to the business carried on within the confines of the United States, but to income received from business transacted in

any foreign country as well. In case of corporations, joint-stock companies, and associations organized under the authority of foreign countries the terms "Gross income," "Net income," and "Authorized deductions" relate only to business transacted within the United States or any state or territory thereof.

ARTICLE 2.—*Gross income.*

The following definitions and rules are given for determining the gross income of the various classes of corporations:

1A. *Banks and other financial institutions.*—Gross income consists of the gross revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income (including dividends received on stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax) derived from all other sources, as shown by the entries on its books from January 1 to December 31 of the year for which return is made.

1B. *Insurance companies.*—Same as 1A above.

2. *Transportation companies.*—Same as 1A above.

3. *Manufacturing companies.*—Gross income received during the year from all sources will consist of the total amount, ascertained through an accounting, that shows the difference between the price received for the goods as sold and the cost of such goods as manufactured. The cost of goods manufactured shall be ascertained by an addition of a charge to the account of the cost of goods as manufactured during the year of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources, including dividends received on

stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax. In the determination of the cost of goods manufactured and sold as above such cost shall comprehend all charges for maintenance and operations of manufacturing plant, but shall not embrace allowances for depreciation of property nor for losses sustained which are to be taken account of in ascertaining the net income subject to tax under the proper heading in the authorized deductions.

4. *Mercantile companies.*—Gross amount of income received during the year from all sources consists of the total amount ascertained through inventory, or its equivalent, which shows the difference between the price received for goods sold and the cost of goods purchased during the year, with an addition of a charge to the account of the sum of the inventory at beginning of the year and a credit to the account of the sum of the inventory at the end of the year. To this amount should be added all items of income received during the year from other sources inclusive of dividends received on stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax. In determining this amount no account shall be taken of allowances for depreciation of property, nor for losses sustained which are to be taken account of in ascertaining the net income subject to tax under the proper heading in the authorized deductions.

5. *Miscellaneous.*—Gross income consists of the gross revenue derived from the operation and management of the business and property of the corporation making the return, together with all amounts of income (including dividends received on stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax) derived from

all other sources as shown by the entries on the books from January 1 to December 31 of the year for which return is made.

It will be noted from these definitions that gross income is practically the same as gross profits, the only difference being that gross income is more inclusive, embracing as it does not only gross profits of the corporation, joint-stock company or association itself, but also all amounts of income received from other sources. It is immaterial whether any item of gross income is evidenced by cash receipts during the year or in such other manner as to entitle it to proper entry on the books of the corporation from January 1 to December 31 for the year in which return is made.

Sale of capital assets.—In ascertaining income derived from the sale of capital assets, if the assets were acquired subsequent to January 1, 1909, the difference between the selling price and the buying price shall constitute an item of gross income to be added to or subtracted from gross income according to whether the selling price was greater or less than the buying price. If the capital assets were acquired prior to January 1, 1909, the amount of increment or depreciation representing the difference between the selling and buying price is to be adjusted so as to fairly determine the proportion of the loss or gain arising subsequent to January 1, 1909, and which proportion shall be deducted from or added to the gross income for the year in which the sale was made. But for the purpose of determining the selling price, as provided in this section, there shall be added to the price actually realized on sale any amount which has already been set aside and deducted from gross income by way of depreciation as defined in article 4 and has not been paid out in making good such depreciation on the property sold.

Where a corporation is engaged in carrying on more than one class of business, gross income derived from the different classes of business shall be ascertained according to the definitions above, applicable thereto.

ARTICLE 3.—*Net income.*

Net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges such as rentals or franchise payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property, if any, and in the case of insurance companies the sums other than dividends, paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds; (third) interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid-up capital stock of such corporation, joint stock company or association, or insurance company, outstanding at the close of the year, and in the case of a bank, banking association, or trust company, all interest actually paid by it within the year on deposits. In case of corporations, joint stock companies, and associations organized under the laws of a foreign country, the proportion of its paid-up capital stock outstanding at the close of the year which the gross amount of its income for the year from business transacted and capital in-

vested within the United States and any of its territories, Alaska, and the district of Columbia bears to the gross amount of its income derived from all sources within and without the United States; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any state or territory thereof, or imposed by the government of any foreign country as a condition to carrying on business therein; (fifth) all amounts received by it within the year as dividends upon stock of other corporations, joint stock companies or associations, or insurance companies, subject to the tax hereby imposed.

The section further provides:

That in the case of a corporation, joint-stock company, or association, or insurance company, organized under the laws of a foreign country, such net income shall be ascertained (by making like deductions) from the gross amount of its income received within the year from business transacted and its capital invested within the United States and any of its territories, Alaska, and the district of Columbia.

Also that:

In the case of assessment insurance companies the actual deposit of sums with state or territorial officers, pursuant to law, as additions to guaranty or reserve fund, shall be treated as being payments required by law to reserve fund.

Also (third paragraph) that:

There shall be deducted from the amount of the net income of each of such corporations, joint-stock companies, or associations, or insurance companies, ascertained as provided in the foregoing paragraphs of this section, the sum of five thousand dollars.

The net income, therefore, is the remainder of the gross income after making the specified deductions.

ARTICLE 4.—*Deductions.*

The specified deductions actually paid within the year, set forth in the statute and as described in article 3 preceding, shall include all proper items of expenses and charges under the respective heads as designated. The amount returned for ordinary and necessary expenses actually paid within the year out of income in maintenance and operation of the business and properties of the corporation should not, however, embrace allowances for depreciation of fixed property which are otherwise to be taken account of under the proper heading in the authorized deductions, nor expenses paid within the year and charged to such allowances for depreciation credited in the current year or in previous years. In ascertaining expenses proper to be included in the deductions to be made under this article, corporations carrying materials and supplies on hand for use should include in such expenses the charges for materials and supplies only to the amount that the same are actually disbursed and used in operation and maintenance during the year for which the return is made.

It is immaterial whether the deductions are evidenced by actual disbursements in cash, or whether evidenced in such other way as to be properly acknowledged by the corporate officers and so entered on the books as to constitute a liability against the assets of the corporation, joint-stock company, association, or insurance company making the return.

Losses.—The deduction for losses must be in respect of losses actually sustained during the year and not compensated by insurance or otherwise. It must be based upon the difference between the cost value and salvage value of the property or assets, including in the latter value such amount, if any, as has in the cur-

rent or previous years been set aside and deducted from gross income by way of depreciation as defined in the following section and not been paid out in making good such depreciation.

Depreciation.—The deduction for depreciation should be the estimated amount of the loss, accrued during the year to which the return relates, in the value of the property in respect of which such deduction is claimed that arises from exhaustion, wear and tear, or obsolescence out of the uses to which the property is put, and which loss has not been made good by payments for ordinary maintenance and repairs deducted under the heading of expenses of maintenance and operation or in the ascertainment of gross income. This estimate should be formed upon the assumed life of the property, its cost value, and its use. Expenses paid in any one year in making good exhaustion, wear and tear, or obsolescence in respect of which any deduction for depreciation is claimed must not be included in the deduction for expense of maintenance and operation of the property or in the ascertainment of gross income, but must be made out of accumulative allowances deducted for depreciation in current and previous years.

ARTICLE 5.—*Inventories.*

It will be noted that an inventory or its equivalent of materials, supplies, and merchandise on hand for use or sale at the close of each calendar year is essential in the case of certain corporations in order to determine the gross income, and in case of other corporations to determine their expenses of operation. Where such inventory or its equivalent was not taken at the close of the year 1908, a supplemental statement showing such inventory approximately must be submitted with the return on the regular form. Such

supplemental statement shall be verified under oath by the treasurer or principal financial officer in submitting the same.

Where any item under any of the deductions is of an unusual nature a special explanatory note referring to such item shall be made and attached to the form at the appropriate place and made a part thereof by proper reference.

Paragraph 3 of said section 38 also provides: * * * and said tax shall be computed upon the remainder of said net income of such corporation, joint stock company or association, or insurance company, for the year ending December thirty-first, nineteen hundred and nine, and for each calendar year thereafter; and on or before the first day of March, nineteen hundred and ten, and the first day of March in each year thereafter, a true and accurate return under oath or affirmation of its president, vice-president, or other principal officer, and its treasurer or assistant treasurer, shall be made by each of the corporations, joint stock companies or associations, and insurance companies, subject to the tax imposed by this section, to the collector of internal revenue for the district in which such corporation, joint stock company or association, or insurance company, has its principal place of business, or, in the case of a corporation, joint stock company or association, or insurance company, organized under the laws of a foreign country, in the place where its principal business is carried on within the United States, in such form as the commissioner of internal revenue, with the approval of the secretary of treasury, shall prescribe.

Each return so made is required to set forth:

(a) The total amount of the paid-up capital stock of such corporations, joint-stock companies or associa-

tions, or insurance companies, outstanding at the close of the year;

(b) The total amount of bonded and other indebtedness of such corporation, joint-stock company or association, or insurance company, at the close of the year;

(c) The gross amount of the income of such corporation, joint-stock company or association, or insurance company, received during the year from all sources, and if organized under the laws of a foreign country, the gross amount of its income received within the year from business transacted and capital invested within the United States and any of its territories, Alaska, and the district of Columbia.

Such returns are also required to set forth the items claimed as deductions (Article 4), also the net income after such deductions have been made.

ARTICLE 6.

Under the authority conferred by this act forms of return have been prescribed, in which the various items specified in the law are to be stated.

Blank forms of this return will be mailed to collectors and should be furnished to every corporation, not expressly excepted, on or before January 1, 1910, and on or before January 1st of each year thereafter. Failure on the part of any corporation, joint-stock company, association, or insurance company liable to this tax, to receive a blank form will not excuse it from making the return required by law, or relieve it from any penalties for failure to make the return in the prescribed time. Corporations not supplied with the proper forms for making the return should make application therefor to the collector of internal revenue in whose district is located its principal place of business. Each corporation should carefully prepare its

return so as to fully and clearly set forth the data therein called for.

Bookkeeping.—No particular system of bookkeeping or accounting will be required by the department. However, the business transacted by corporations, joint-stock companies, associations, or insurance companies must be so recorded that each and every item therein set forth may be readily verified by an examination of the books and accounts, where such examination is deemed necessary.

Calendar year.—As the law specifically provides that the tax imposed shall be computed on the net income during each "*calendar year*," returns of income based on any period other than the calendar year can not be accepted.

Corporations organized during the year or going into liquidation during the year should nevertheless render a sworn return on the prescribed form.

ARTICLE 7.

Collectors will see that as soon as each return made by any corporation is received a record on Form 632 is made, setting out the name of the corporation making the return, the nature of the principal business transacted, the location of principal place of business, with net income reported, and the date on which such return was received. The date of receipt in each case will be noted in the last column of that form, in which column the list on which assessment is made will also be noted. For this purpose the column so used may be subdivided, or the date of receipt of such returns may be noted in red ink over the date entered therein as to such assessment list.

Any collector will, whenever it appears advisable to do so, request that a revenue agent be specially designated to collect and furnish this office with such other

data as, in his judgment, is necessary to determine the actual amount of tax to be assessed against any corporation, joint-stock company, or association which under the law set forth in these regulations is required to make return.

Such returns are required to be made not later than March 1 of each year, and any failure to comply with the law in this regard should be at once reported by the collector to the commissioner of internal revenue.

To enable collectors to determine whether all returns due have been received, a careful canvass of each district should be made, and all corporations, joint-stock companies, and associations subject to the tax imposed should be listed as above directed.

ARTICLE 8.

For statistical purposes all such corporations, joint-stock companies, and associations will be classified as follows:

CLASS A: *Financial and commercial.*—Including banks, banking associations, trust companies, guaranty and surety companies, title insurance companies, building associations (if for profit), and insurance companies, not specifically exempt.

CLASS B: *Public service.*—Such as railroads, steamboat, ferryboat, and stage-line companies; pipe-line, gas, and electric-light companies; express, transportation, and storage companies; telegraph and telephone companies.

CLASS C: *Industrial and manufacturing.*—Such as mining, lumber, and coke companies; rolling mills; foundry and machine shops; sawmills; flour, woolen, cotton, and other mills; manufacturers of cars, automobiles, elevators agricultural implements, and all articles manufactured wholly or in part from metal, wood, or other material; manufacturers or refiners of

sugar, molasses, sirups, or other products; ice and refrigerating companies; slaughterhouse, tannery, packing, or canning companies, etc.

CLASS D: *Mercantile*.—Including all dealers (not otherwise classed as producers or manufacturers) in coal, lumber, grain, produce, and all goods, wares, and merchandise.

CLASS E: *Miscellaneous*.—Such as architects, contractors, hotel, theater, or other companies, or associations, not otherwise classed.

When classified as above indicated the names of the various corporations, companies, and associations will be listed alphabetically, and will be numbered consecutively (commencing with No. 1 in *each* class), and in forwarding returns or papers subsequently rendered or submitted by such corporations or companies collectors will see that the same have placed thereon the designating class letter and number corresponding with those noted on the lists herein required to be furnished.

ARTICLE 9. *Examination of books, etc., by revenue agent.*

Paragraph 4 of said section 38 provides:

Fourth. Whenever evidence shall be produced before the commissioner of internal revenue which in the opinion of the commissioner justifies the belief that the return made by any corporation, joint stock company or association, or insurance company, is incorrect, or whenever any collector shall report to the commissioner of internal revenue that any corporation, joint stock company or association, or insurance company has failed to make a return as required by law, the commissioner of internal revenue may require from the corporation, joint stock company or association, or insurance company making such return such

further information with reference to its capital, income, losses, and expenditures as he may deem expedient; and the commissioner of internal revenue, for the purpose of ascertaining the correctness of such return or for the purpose of making a return where none has been made, is hereby authorized, by any regularly appointed revenue agent specially designated by him for that purpose, to examine any books and papers bearing upon the matters required to be included in the return of such corporation, joint stock company or association, or insurance company, and to require the attendance of any officer or employee of such corporation, joint stock company or association, or insurance company, and to take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons; and the commissioner of internal revenue may also invoke the aid of any court of the United States having jurisdiction to require the attendance of such officers or employees and the production of such books and papers. Upon the information so acquired the commissioner of internal revenue may amend any return or make a return where none has been made. All proceedings taken by the commissioner of internal revenue under the provisions of this section shall be subject to the approval of the secretary of the treasury.

ARTICLE 10.—*Assessment and collection of tax, etc.*

Paragraph 5 of said section 38 provides:

Fifth. All returns shall be retained by the commissioner of internal revenue, who shall make assessments thereon; and in case of any return made with false or fraudulent intent, he shall add one hundred per centum of such tax, and in case of a refusal or neglect to make a return or to verify the same as

aforesaid he shall add fifty per centum of such tax. In case of neglect occasioned by the sickness or absence of an officer of such corporation, joint stock company or association, or insurance company, required to make said return, or for other sufficient reason, the collector may allow such further time for making and delivering such return as he may deem necessary, not exceeding thirty days. The amount so added to the tax shall be collected at the same time and in the same manner as the tax originally assessed unless the refusal, neglect, or falsity is discovered after the date for payment of said taxes, in which case the amount so added shall be paid by the delinquent corporation, joint stock company or association, or insurance company, immediately upon notice given by the collector. All assessments shall be made and the several corporations, joint stock companies or associations, or insurance companies, shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the commissioner of internal revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as above provided for, and the assessment made by the commissioner of internal revenue thereon shall be paid by such corporation, joint stock company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest

at the rate of one per centum per month upon said tax from the time the same becomes due.

Upon the receipt and verification of the returns rendered, the tax as ascertained to be due will be assessed as above prescribed; and notice of such assessment will be given and subsequent demand made (if necessary) on forms 17 and 21, respectively.

In case of failure to make returns within the time and manner required by the statute, or where the return rendered is found or believed to be incorrect, action in such cases will be taken, as provided in paragraph 4 of the law.

The additional tax imposed by paragraph 5 of the law for failure to make the required return, or for making a false or fraudulent return, will in all cases be assessed as therein provided.

ARTICLE 11.—*Returns to constitute public records.*

Paragraph 6 of said section 38 provides:

Sixth. When the assessment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the commissioner of internal revenue and shall constitute public records and be open to inspection as such.

ARTICLE 12.—*Penalties.*

Paragraphs 7 and 8 of section 38 provide:

Seventh. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or make known in any manner whatever not provided by law to any person any information obtained by him in the discharge of his official duty, or to divulge or make known in any manner not provided by law any document received, evidence taken, or report made under this section ex-

cept upon the special direction of the president; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding one thousand dollars, or by imprisonment not exceeding one year, or both, at the discretion of the court.

Eighth. If any of the corporations, joint stock companies or associations, or insurance companies, aforesaid, shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint stock company or association, or insurance company shall be liable to a penalty of not less than one thousand dollars and not exceeding ten thousand dollars.

Any person authorized by law to make, render, sign, or verify any return who makes any false or fraudulent return, or statement, with intent to defeat or evade the assessment required by this section to be made, shall be guilty of a misdemeanor, and shall be fined not exceeding one thousand dollars or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

ARTICLE 13.—*Certain revenue laws made applicable, and jurisdictions conferred on United States courts to compel attendance of witnesses, etc.*

Paragraph 8 further provides:

All laws relating to the collection, remission, and refund of internal-revenue taxes, so far as applicable to and not inconsistent with the provisions of this section, are hereby extended and made applicable to the tax imposed by this section.

Jurisdiction is hereby conferred upon the circuit and district courts of the United States for the district within which any person summoned under this

section to appear to testify or to produce books, as aforesaid, shall reside, to compel such attendance, production of books, and testimony by appropriate process.

ARTICLE 14.—*Collection of tax.*

The tax assessed under the provisions of this act will be collected and will be receipted for on Form 1, as in the case of other assessed taxes. Unless paid within the time fixed by the statute, notice and demand should be at once issued, and, in case of nonpayment, distraint proceedings should be instituted without delay.

FORMS.

ARTICLES OF INCORPORATION

OF THE

AMALGAMATED TRACTION COMPANY.

KNOW ALL MEN BY THESE PRESENTS, That we, C. O. Bassett, E. J. Peterson, J. C. Mountain, R. W. Atkinson, and J. R. Brown, a majority of whom are citizens and residents of the state of ———, having voluntarily associated ourselves together as a body corporate under and by virtue of the laws of the State of ——— do to that end hereby publish and declare these articles of incorporation in triplicate as follows:¹

¹ This form is sufficient and may be used in any of the Pacific states. Indeed, with one or two exceptions it would be sufficient in any state in the union. In all of the states except sixteen the statutes require not less than three incorporators. Of these sixteen states, the statutes of Kansas, Maryland, New Hampshire, Ohio, Tennessee, Utah, Vermont, and West Virginia require not less than five. In Nebraska, Iowa and Arizona any number of persons is sufficient. In Georgia any number more than one. In Vermont, Mississippi, and Washington two or more. In California and Kansas a majority of the incorporators must reside within the state; in Idaho and Utah at least one of incorporators. Very few of the states have any requirements as to residence or citizenship.

I.

The name of the corporation shall be "Amalgamated Traction Company."²

II.

The objects and purposes for which the corporation is formed are, and shall be, to carry on and conduct a general industrial, manufacturing, mechanical, improvement and building business in the State of ——— and in all the states and territories of the United States; to purchase, acquire, own, lease, hold, sell, mortgage and encumber both improved and unimproved real estate; to purchase, acquire, own, hold, sell, mortgage and encumber personal property of every kind and description; to construct, erect, maintain, purchase, acquire, own, hold, lease, sell, mortgage and encumber buildings, work-shops and plants of every kind and nature whatsoever; to purchase, erect, maintain, acquire, own, hold, lease, sell, mortgage and encumber manufacturing plants, manufacturing establishments, engines, machinery, equipment and fixtures of every kind and description necessary, convenient or proper for the establishment, maintenance and operation of a general manufacturing plant, or necessary, proper or convenient for the manufacturing of all kinds of goods, wares and merchandise and preparing the same for market, traffic and sale; to buy and sell, and otherwise to deal or traffic in, manufactured goods and articles of every kind and

² The form used here will fulfill the requirement of any of the statutes of the Pacific states. It should be noted that the statute of Colorado requires that the name shall commence with "The" and end with "Corporation," "Company," "Association" or "Society." In Nevada, the name must end with "Incorporated," "Association," "Company," "Corporation," "Club," "Society" or "Syndicate." In Idaho, the name should contain the word "Limited."

nature; to acquire, own, mortgage, use, hold and dispose of any and all property, assets, stocks, bonds and rights of any and every kind; to acquire by purchase, subscription, or otherwise, and to hold or dispose of stocks, bonds or other obligations of other corporations, and, while owner of any such stock, bonds, or other obligations, to exercise all the rights, powers and privileges of ownership thereof, and to exercise any and all voting power thereon; to borrow money and issue notes, mortgages, bonds, debentures and any other evidence of indebtedness.

To apply for, obtain, register, purchase, lease or otherwise to acquire, and to hold, use, own, operate and introduce, and to sell, assign, or otherwise dispose of, any trademarks, trade-names, patents, inventions, improvements and processes used in connection with or secured under letters patent of the United States, or elsewhere, or otherwise; and to use, exercise, develop, grant licenses in respect of, or otherwise turn to account any such trademarks, patents, licenses, processes and the like, or any such property or rights.

Without in any particular limiting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue stock and bonds and other obligations in payment for property purchased or acquired by it, or for any other object in or about its business; to mortgage or pledge any stock, bonds or other obligations, or any property which may be acquired by it, to secure any bonds or other obligations by it issued or incurred; to guarantee any dividends or bonds or contracts or other obligations; to make and perform contracts of any kind and description; and in carrying on its business, or for the purpose of attaining or furthering any of its objects, to do any and all other acts and things, and to exercise any and

all other powers not inconsistent with the laws of the state of ——— or of the United States.³

* All of the Pacific states are very liberal in permitting comprehensive articles of incorporation to be filed. In Arizona, any number of persons may associate themselves together and become incorporated for the transaction of any lawful business, but such corporation shall confer no powers or privileges not possessed by natural persons, except as herein provided—To make contracts, acquire and transfer property, possessing the same powers in such respects as private individuals now enjoy.

California: Private corporations may be formed for any purpose for which individuals may lawfully associate themselves.

Colorado: For any lawful business.

Idaho: Private corporations may be formed for any purpose for which individuals may lawfully associate themselves.

Kansas: Practically any lawful business.

Montana: Practically any lawful business.

Nevada: Any number of persons, not less than three, may associate to establish a corporation for the transaction of any lawful business, or to promote or conduct any legitimate object or purpose under the provisions of and subject to the requirements of this state; except to carry on within the state, an insurance business or that of a surety company, or that of a railroad company, other than a street railroad.

New Jersey: For any lawful purpose.

New Mexico: Practically any lawful business.

Oregon: Whenever three or more persons shall desire to incorporate themselves, for the purpose of engaging in any lawful enterprise, business, pursuit, or occupation, they may do so under the laws of this state.

South Dakota: Corporations may be formed under the laws of South Dakota to carry on practically any lawful business.

Utah: Private corporations may be formed for any purpose for which individuals may lawfully associate.

Washington: Private corporations may be formed under the laws of this state for practically any lawful business.

Wyoming: Private corporations may be formed for the purpose of carrying on any kind of manufacturing, mining, mechanical, merchandizing or chemical business, constructing wagon roads, railroads, telegraph lines, digging ditches, building flumes, running tunnels, dealing in real estate, or carrying on any branch of business designated to aid in the industrial or productive interests of the country.

Under the statute of Minnesota, the above form should not be used in its comprehensive nature for manufacturing corporations,

III.

The capital stock of the corporation is Two hundred thousand (\$200,000) Dollars divided into Two thousand (2,000) shares of the par value of One hundred (\$100) Dollars each.⁴

by reason of the fact that under the statute of this state where the corporation is organized as a manufacturing corporation, and the operation is confined to that alone, the stockholders' liability is more limited than in other corporations; also there is a difference in the cost of the incorporation fee. Under the decisions in this state the articles of incorporation will be the sole criterion as to the purposes of the corporation.

For corporations other than manufacturing it will be necessary of course to use a different form of "objects and purpose" clause; appropriate forms will be found under title of "Object and Purpose Clauses," *infra*.

⁴ Nearly all the states have statutes requiring the amount of the capital stock, together with the par value thereof, to be set forth in the articles of incorporation. This is particularly true of all the Pacific states. The above form may be used in any of these states. If preferred stock is to be issued by the corporation, then there should be added to this form the following, "Of such capital stock, One thousand (1,000) shares amounting to One hundred thousand (\$100,000) Dollars shall be preferred stock, and One thousand (1,000) shares amounting to One hundred thousand (\$100,000) Dollars shall be common stock." It is also proper, if desired, to set forth the nature of the preferred stock. For instance, the form used by the U. S. Steel Corporation is as follows: "The Holders of the preferred stock shall be entitled to receive, when and as declared, from the surplus or net profits of the corporation, yearly dividends at the rate of seven per cent per annum and no more, payable quarterly on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividends on the common stock shall be paid or set apart; so that, if in any year dividends amounting to seven per cent shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid upon or set apart for the common stock.

"Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared and the same have become payable, and the accrued quarterly installments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the Board of Directors may

IV.

The time and duration of this corporation shall be _____ years from the date of its creation,⁵ and its principal office and place of business shall be located in the City of _____, _____ County, in the State of _____.⁶

declare dividends on the common stock, payable then or thereafter, out of any remaining surplus or net profits.

"In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the corporation, the holders of the preferred stock shall be entitled to be paid in full both the par amount of their shares and the unpaid dividends accrued thereon before any amount shall be paid to the holders of the common stock; and, after the payment to the holders of preferred stock of its par value and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their shares."

In nearly all the states there is no statutory provision regulating the amount of the par value of the stock. The exceptions to this general rule is to be found in the following states: In Arkansas the par value must be fixed at not less than \$25 or more than \$100 per share; in Colorado not less than \$1 nor more than \$100; Connecticut, not less than \$25; Florida, not less than \$10; Illinois, not less than \$10 or more than \$100; Indiana, not more than \$100; New York, not less than \$5 or more than \$100; Massachusetts, not less than \$5; Michigan, not less than \$10 nor more than \$100; New Hampshire, not less than \$25 nor more than \$500; Pennsylvania, not more than \$100; Tennessee, not more than \$100.

⁵ In many of the eastern states corporations may be organized with perpetual existence. This is true of New Jersey, New York, Pennsylvania, Maine, Massachusetts, Connecticut, Delaware, Florida, Kentucky, Maryland, and New Hampshire. The reverse is true of the western states, as the statutes of all the western states, with the possible exception of Oregon and Nevada, place a time limit. In Arizona and South Dakota corporations may be organized to exist for a period of twenty-five years. In California, Indiana, Idaho, Kansas, New Mexico, Washington, and Wyoming for fifty years. In Georgia, Colorado and Missouri for twenty years. In Montana it would seem that the period of duration depends on the nature of the corporation. In certain classes of corporations, under the old law, in this state the period of limitation is fixed at twenty years, while under a later law, which enumerates another class of corporations, the limitation is fixed at forty years. In Utah the limitation is one hundred years. In Illinois and Louisiana ninety-nine years.

⁶ The statutes of nearly all of the states require that the principal

V.

The affairs of the corporation shall be managed by a board of trustees,^{6a} which board shall consist of five members, and C. O. Bassett, E. J. Peterson, J. C. Mountain, R. W. Atkinson and J. R. Brown shall be the trustees of said corporation at the time of its creation and shall manage the affairs of said corporation until the 1st day of August, 1911.⁷

office or principal place of business shall be designated in the articles of incorporation. In the states of Arizona, Georgia and Maine this is probably unnecessary, although it is believed to be the better practice.

^{6a} The Washington statute uses the word "Trustees." Nearly all of the other statutes of the different states use the word "Directors."

⁷ The statutes of all the states, with the exception of Arizona, Illinois, Iowa, Louisiana, Maine, Maryland, Minnesota, New Mexico, Nebraska, Ohio, Rhode Island, South Carolina and Delaware, require a board of not less than three members. Most of these statutes also fix the maximum number. Thus, in Colorado it is provided that there shall be not more than thirteen directors, except mining companies are limited to nine. In Florida, not more than thirteen; Idaho, not more than fifteen; Indiana, not more than eleven; Kansas, not more than twenty-four; in North and South Dakota, not more than eleven; Oklahoma, not more than eleven; Montana, not more than fifteen; Utah, not more than twenty-five. As to residence qualifications, many of the states provide that a certain number of the directors must reside in the state. Thus, Oregon and California statutes provide that a majority of the directors must reside in the state. Idaho, at least one; Washington, at least one; South Dakota, one; Utah, one; Delaware, one; New York, one.

For Arizona it will be necessary to add to the above form the highest amount of indebtedness or liability to which the corporation may, at any time, be subjected, which amount is not to exceed two-thirds the amount of the corporate stock; also, that private property of the stockholders shall be forever exempt from corporate debts.

In Kentucky the articles should contain the highest amount of indebtedness or liability to which the corporation may, at any time, be subject; also, if the private property of the stockholders is not to be subjected to corporate debts it should be so stated in the articles. The above suggestion applies, also, to the state of Iowa.

In Minnesota the certificate of incorporation should state the high-

IN WITNESS WHEREOF: We have set our hands and seals to these articles of incorporation in triplicate this 9th day of April, 1911.

C. O. BASSETT,
E. J. PETERSON,
J. C. MOUNTAIN,
R. W. ATKINSON,
J. R. BROWN.

STATE OF, ———, }
County of ———. } ss.

This certifies that on this ——— day of ———, ———, before me the undersigned Notary Public, in and for the State and County aforesaid, personally appeared the within named C. O. Bassett, E. J. Peterson, J. C. Mountain, R. W. Atkinson, and J. R. Brown who are known to me to be the identical individuals described in the foregoing instrument and acknowledged to me that they executed the same freely and voluntarily for the uses and purposes therein mentioned.

IN WITNESS WHEREOF: I have hereunto set my hand and fixed my seal the day and year above written.

Notary Public in and for the State of
———, residing at ———, ———.

The articles of incorporation after having been prepared will be filed with the proper officers of the

est amount of indebtedness or liability to which the corporation shall, at any time, be subjected.

For California it will be necessary to set forth in the articles the amount of capital stock actually subscribed and the names of the persons by whom such stock has been subscribed. This same suggestion applies also to Idaho, Utah, Montana, New Jersey, Delaware, Kansas, Michigan Missouri, and Pennsylvania. In Colorado, Montana and Wyoming it will be necessary to name the county or counties in which the principal part of the business or operations of the company are to be carried on. The form of verification above given will be sufficient for any of the states.

county and state under whose laws incorporation is sought.⁸ The articles, of course, must be accompanied with the necessary filing fees.

The articles of incorporation having been signed in the manner heretofore suggested and a certificate having been issued and placed in the hands of the person

⁸ In Arizona, it will be necessary to have the articles of incorporation filed for record in the office of the county recorder and a certified copy with the state auditor. In California, the articles must be filed with the clerk of the county in which the principal place of business of the corporation is located. The county clerk of such county will then prepare a certified copy thereof, which, in turn, will be filed with the secretary of state. Thereupon, the secretary of state will issue a certificate to the corporation. In Colorado, the articles of incorporation will in the first instance be filed in the office of the secretary of state, after which a certified copy must be filed with the recorder of the county wherein the principal place of business of the corporation is located, and where the principal business of the corporation is carried on. In Idaho, the articles must be filed with the recorder of the county wherein the principal place of business of the corporation is located, after which a certified copy, certified to by such recorder shall be filed with the secretary of state. In Montana, the procedure is the same as in Idaho. In New Mexico, the articles are filed with the secretary of state, after which a certified copy, certified to by such secretary shall be filed for record with the recorder of the county wherein is located the principal place of business of the corporation. In Nevada, the articles will be filed with the clerk of the county wherein is located the principal place of business, and thereafter a certified copy, certified to by such clerk, shall be filed with the secretary of state. In Oregon, the filing must first be done with the secretary of state, and thereafter a copy must be filed with the clerk of the county wherein the corporate business is to be carried on. In South Dakota, the articles are filed with the secretary of state. In Utah, the articles of incorporation, together with the incorporators' agreement, and the oath of office, must be filed with the county clerk, and thereafter with the secretary of state. In Washington, three copies of the articles shall be prepared, one of which shall be filed with the secretary of state, another with the auditor of the county wherein the principal place of business of the corporation is located, the third copy shall be kept among the permanent records of the corporation. In Wyoming, a copy of the articles must be filed in each county wherein the company transacts business, also a copy filed with the secretary of state.

in charge of the incorporation, the next step will be the calling and holding of the organization meeting. This meeting should always be held within the state of incorporation. Of the Pacific States New Mexico, Nevada, Oregon and Washington have express statutory provisions providing for the calling and holding of this meeting. Many of the eastern States have like statutory provisions, among them, Delaware, Indiana, Massachusetts, New Jersey, Ohio, and Rhode Island. Usually the plan pursued is to have all of the incorporators together with the subscribers to the capital stock, sign a written waiver waiving call and notice of the meeting and consenting to the holding of such meeting at such designated time or place. Where, however, this cannot be done or if for any reason inadvisable then it will be necessary to call and hold this meeting in the manner and form prescribed by the state. In New Jersey the statute provides that this meeting shall be called by notice signed by a majority of the incorporators. The notice must be published in some newspaper of the county where the corporation is established, for at least two weeks before the meeting. In Washington, the meeting may be called by one or more of the trustees named in the articles of incorporation. The call must be published in some newspaper at the principal place of business of the corporation at least twenty days before the meeting. The notice, of course, will always designate the time, place and purpose of the meeting. This having been done, a meeting will be called and held at the time and place designated and the records of the corporation will appear approximately as follows:

MINUTES OF THE ORGANIZATION MEETING
OF THE AMALGAMATED TRACTION COM-
PANY HELD IN THE CITY OF _____
STATE OF _____, APRIL 18,
1911, AT 2:30 P. M.

The organization meeting of the Amalgamated Traction Company was called and held on this _____ day of _____, _____, pursuant to a written waiver and consent signed by all of the subscribers to the capital stock of this company, together with all of the incorporators as named in the articles of incorporation. J. R. Brown was appointed and selected as chairman of the meeting and E. J. Peterson as secretary.

The chairman then called the meeting to order and stated the objects and purposes for which the meeting had been called. At his request, the secretary produced the written waiver and consent, signed by all of the subscribers to the capital stock, together with all the incorporators named in the articles of incorporation, which waiver and consent, after having been read, was on motion duly made, seconded and unanimously carried, ordered filed among the permanent records of the corporation and is as follows, to-wit:

"We, the undersigned, being all of the subscribers to the capital stock and being the incorporators of the Amalgamated Traction Company, hereby and by these presents do call the organization meeting of said corporation to be held at the office of the Company, to-wit: _____, in _____, _____, at _____ on the _____ day of _____, _____; then and there to accept the corporate charter, adopt by-laws for the government of the corporation, purchase property that may be agreed upon and generally to do any and all things necessary and proper to perfect the organization of said corpo-

ration. Therefore, we, and each of us, hereby expressly waive all statutory and charter requirements as to notice and agree to meet in said meeting at the time and place hereinbefore fixed and transact the business herein named, together with such other and further business as may be properly presented at said meeting.

Dated at ———, ———, this ——— day of ———, ———. C. O. Bassett, E. J. Peterson, J. C. Mountain, R. W. Atkinson, J. R. Brown.

A roll call was then had. There were present in person at the meeting: C. O. Bassett, E. J. Peterson, J. C. Mountain, R. W. Atkinson and J. R. Brown.

The secretary then produced a certificate, regularly issued by the proper officers of the state, with the statement that the articles of incorporation had been filed with the proper officers of the state and county, which certificate, after having been read by the secretary, was on motion duly made, seconded and unanimously carried, ordered recorded among the permanent records of the corporation.

On motion duly made, seconded and unanimously carried, the charter and certificate of incorporation were accepted. The secretary then produced a stock subscription, which subscription, after reading was on motion duly made, seconded and unanimously carried, accepted and ordered spread upon the minutes of this meeting, and is as follows to-wit:

“We, the undersigned hereby severally subscribe for the number of shares set opposite our respective names of the Amalgamated Traction Company and agree to pay therefore on demand, one hundred dollars per share. C. O. Bassett, 100 shares, E. J. Peterson, 100 shares, J. C. Mountain, 100 shares, R. W. Atkinson, 100 shares, J. R. Brown, 100 shares.”

The secretary then presented a code of by-laws, and stated that the same had been prepared by the counsel of the company, under the direction of the incorporators, which by-laws after having been read, article by article, were unanimously adopted as the by-laws of the corporation and are as follows, to-wit:

NOTE.—Where the following form of By-laws is used in state of Washington “Trustees” instead of “Directors” must be used.

CODE OF BY-LAWS OF THE AMALGAMATED TRACTION COMPANY.

ARTICLE I. CORPORATE POWERS.

The corporate powers of this corporation shall be vested in a board of five directors, who shall be stockholders holding one or more shares of stock in their own names on the books of the corporation at the time of their election and three shall constitute a quorum for the transaction of business.

ARTICLE II. ELECTION OF DIRECTORS.

The directors shall be elected by ballot, at the annual meeting of the stockholders, to serve for one year and until their successors are elected and qualified. Their term of office shall begin immediately after election. Whenever any director shall sell or dispose of all of his shares of stock in the corporation, such act shall, ipso facto, vacate such office and he shall no longer act as such.

ARTICLE III. VACANCIES.

Vacancies on the board of directors caused by the death, resignation, or refusal of directors to act shall be filled by the other directors in office. Such persons shall hold office until the first meeting of the stockholders thereafter.

ARTICLE IV. POWER OF DIRECTORS.

The corporate powers, business, property and interests of this corporation shall be exercised, conducted and controlled by the board of directors, who shall have power to conduct, manage and control its business and affairs and to make rules and regulations not inconsistent with the laws of this state, nor these by-laws; to appoint and remove at pleasure all officers, agents and employees, prescribing their duties and fixing their compensation; to call special meetings of the stockholders when they deem it necessary; to incur indebtedness, the terms and amounts of which shall be entered on the minutes of the board, and the note or obligation given for the same, signed officially by the president and secretary shall be binding on the corporation.

It shall be the duty of directors to cause to be kept a complete record of all minutes and acts, and of the proceedings of the stockholders, and to present a full statement at the regular meeting of the stockholders showing in detail the assets and liabilities of the corporation, and generally the condition of the affairs. A similar statement shall be presented at any other meeting of the stockholders when required by persons holding at least one-third of the capital stock of the corporation; to declare dividends out of the surplus profits when such profits shall in the opinion of the directors warrant the same; to supervise all officers, agents, employees and see that their duties are properly performed.

ARTICLE V. OFFICERS.

The officers of this corporation shall be president vice-president, secretary, treasurer, general manager, auditor and general counsel; which officers shall be elected by and hold office at the pleasure of the board

of directors. The compensation and tenure of office of all officers of the corporation, other than the directors, shall be fixed and determined by the board of directors. The president and vice-president shall be selected from among the directors.

ARTICLE VI. PRESIDENT.

The president shall preside over all meetings of the stockholders and directors; he shall sign as president all certificates of stock and all contracts and other instruments in writing, which have been first approved by the board of directors; he shall submit at each annual stockholders' meeting a full and complete report and statement of the affairs of the corporation. He shall make from time to time such reports to the board of directors concerning the business affairs of the corporation as shall be requested of him by such directors; he shall call the directors together whenever he deems it necessary and shall have, subject to the advice of the directors, direction of the affairs of the corporation, and generally shall discharge such other duties as may be required of him by the laws of the state, the charter of the corporation, and these by-laws.

ARTICLE VII. VICE-PRESIDENT.

It shall be the duty of the vice-president to preside at all meetings of the stockholders and directors in the absence or disability of the president. In case of the removal of the president from office, or of his death, resignation, or disability to discharge the duties of his office, the same shall devolve upon the vice-president.

ARTICLE VIII. SECRETARY.

It shall be the duty of the secretary to keep a record of the proceedings of the stockholders, the board of directors and all committees which record shall embrace the time and place of holding the meeting, whether

regular or special, and if special, its object, how authorized, and a notice thereof. Also such records shall embrace every act done or ordered to be done; who were present and who absent, and if requested by any director, member or stockholder, the time must be noted when he entered the meeting, or obtained leave of absence therefrom. He shall keep the corporate seal of the corporation and the book of blank certificates of stock; fill up and countersign all certificates issued and make the corresponding entries in the margin of such book on such issuance and shall fix said seal to all papers requiring a seal. He shall keep a proper transfer book and stock ledger, showing the number of shares issued to and transferred by any stockholder, and the dates of such issuance and transfer.

He shall also keep a record of all stock; the names of the stockholders or members alphabetically arranged; assessments levied, paid and unpaid; a statement of every alienation, sale or transfer of stock made; the date thereof; and by whom made. He shall keep proper account books and discharge such other duties as belong to his office and as are prescribed by the board of directors. He shall serve all notices required either by law or the by-laws of the company, and in case of his absence, inability, refusal or neglect so to do, then such notice may be served by any person directed so to do by the president or vice-president of the company.

He shall make such reports to the stockholders, the board of directors and the executive committee as they shall from time to time request.

ARTICLE IX. TREASURER.

The treasurer of this corporation shall be the lawful custodian of the corporate funds and securities. He

shall deposit all funds belonging to the corporation in the name of the corporation in such bank or banks as the board of directors shall elect. He shall sign all checks drafts, notes and orders for the payment of money, and shall pay out and dispose of the same under the direction of the president or the board of directors, taking, in all cases, proper vouchers for such disbursements. He shall at all reasonable times exhibit the books, records, accounts and vouchers to any directors or stockholder of the company upon application of such person to the principal offices of the corporation within business hours of any day except Sundays and legal holidays. He shall execute a bond with two good and sufficient securities, in such form as shall be required by the board of directors, and do such other things incident to his office as shall be required of him by the board of directors.

ARTICLE X. GENERAL MANAGER.

The general manager shall, under the supervision and control of the board of directors and the president, have charge of and manage the business operations of the company. He shall perform such further duties and make such reports as may be required of him by the board of directors or the president, and shall receive such salary as may be fixed and determined by the board of directors.

ARTICLE XI. GENERAL COUNSEL.

The general counsel shall be the legal advisor of the corporation; he shall, when requested by the board of directors, take part in their deliberations in an advisory capacity; he shall examine and prepare all documents, agreements and contracts for the corporation as may be requested and referred to him by the board of directors; he shall represent the company in any and all litigations brought by or against it, and shall

have authority to verify any and all pleadings brought by or against it. He shall receive such retainer and compensation as shall be fixed and determined by the board of directors.

ARTICLE XII. AUDITOR.

It shall be the duty of the auditor of the company to examine once every three months all books, records, receipts, bills and vouchers on file in the office of the company, and report to the board of directors, within ten days after having made such examination, the correctness or incorrectness, and the general condition of all such books, records, bills and vouchers. It shall also be his duty to examine the financial condition of the corporation, its outstanding debts and obligations and report the same with such recommendations and suggestions as in his judgment seem right and proper under the circumstances. He shall also at the annual meeting of the stockholders submit his reports of the condition of the corporation with such recommendations and suggestions as, in his judgment, are proper.

ARTICLE XIII. BOOKS, RECORDS, PAPERS.

The books, records and papers of the corporation shall be kept at the principal office and be subject to inspection by the board of directors and any of the stockholders within business hours of any day except Sunday, and legal holidays.

ARTICLE XIV. CERTIFICATES OF STOCK.

Certificates of stock shall be of such form and device as the board of directors shall direct, and every person who shall become a stockholder of the corporation shall be entitled to a certificate of stock, issued in numerical order, signed by the president and countersigned by the secretary, bearing an imprint of the seal of the corporation; which certificate shall express on

its face the name of the person to whom it is issued, the number of shares to which such person is entitled, and the date of its issuance. The certificate stock book shall contain a margin on which shall be entered the number, date, number of shares, the name and address of the person expressed in the corresponding certificate.

ARTICLE XV. TRANSFER OF STOCK.

Shares in the corporation may be transferred at the principal place of business within business hours by the holder thereof or by his attorney, duly and regularly constituted, or by his legal representatives, by surrendering to the secretary of the corporation the certificate representing the transferred stock, duly and regularly endorsed. No transfer shall be made or new certificate issued until the certificate representing the transferred stock shall have been surrendered to the corporation; which certificate, when surrendered, shall be cancelled by the secretary and attached to the stub in the stock certificate book from which the same was originally detached.

All stock and transfer books shall be closed for transfers fifteen days before the annual meeting of the stockholders and ten days before dividend days. A transfer fee of 50 cents for each and every certificate issued representing transferred stock shall be charged, which amount shall be collected by the secretary prior to the transferring of said stock.

ARTICLE XVI. LOST CERTIFICATES.

The board of directors may cause to be issued a new certificate of stock in the place of any certificate theretofore issued but alleged to have been lost or destroyed. Before such new certificate or certificates shall be issued, however, the owner of such lost or destroyed certificate or certificates shall be required to give the corporation a bond in such sum, not less than

the par value of the stock, as may be directed by the board of directors, as indemnity against any claim that may be made against such corporation. The board of directors may refuse to issue such new certificate until ordered by a court of competent jurisdiction.

ARTICLE XVII. ANNUAL MEETING OF STOCKHOLDERS.

The annual meeting of the stockholders shall be held at the principal place of business of this corporation at 2 P. M. on the 1st day of August of each year, if not a legal holiday, if a legal holiday then on the day following, for the election of a board of directors and for the transaction of any other business that may properly come before such stockholders' meeting.

ARTICLE XVIII. SPECIAL MEETING OF STOCKHOLDERS.

Special meetings of the stockholders may be called and held by the shareholders of this corporation at any time at the principal place of business of this corporation for the determination of any questions pertaining to this corporation or its business affairs. Such meetings may be called by the board of directors, and it shall be their duty to call such meeting at the written request of stockholders owning and holding at least one-third of the outstanding stock. The call for such meeting shall clearly specify the time, place and object, or objects thereof, and it shall not be lawful to transact business not specified in the call and notice.

ARTICLE XIX. NOTICE OF MEETINGS.

All regular and special meetings of the stockholders shall be called by notices printed in one or more newspapers of general circulation published at the principal place of business of this corporation, as the directors may direct, for at least fifteen days next preceding the date of such meeting. If there be no news-

paper published at the place of business of the corporation, then such notice shall be published in the newspaper nearest thereto. In all special meetings such notice shall state the time, place, object or objects of such meeting or meetings. In case of regular annual meetings of the stockholders, no irregularity in the notice thereof shall invalidate such meeting or the proceedings had thereat.

ARTICLE XX. QUORUM.

No meeting of the stockholders shall be competent to transact business unless a majority of the shares of stock issued and outstanding shall be present, except to adjourn from day to day, or until such time as they deem proper. Where a majority of the shares issued and outstanding shall be present at any corporate meeting called and held as herein provided, a vote of the majority of the shares represented shall decide any question or matter properly brought before such meeting.

ARTICLE XXI. PROXIES.

Any stockholder may be represented at any meeting, either regular or special, of the shareholders of this company by an attorney lawfully constituted. The power of such attorney or representative must be in writing, signed by the stockholder and filed with the secretary of the corporation not less than fifteen days next preceding the date of the meeting. The holder of such power of attorney shall be entitled to the same rights and privileges as a stockholder if personally present and all his acts, as such shall be binding upon such stockholder.

ARTICLE XXII. VOTING.

Only such persons as are stockholders of record on the books of the corporation shall be entitled to par-

ticipate in or vote at corporate meetings. All elections shall be by ballot and every stockholder shall have the right to cast one vote, in person or by proxy, for each share of stock owned by him and standing in his name on such books.

ARTICLE XXIII. ELECTION OF DIRECTORS.

There shall be elected at the first meeting of the stockholders, a board of directors of such qualifications, and with such powers and duties as are prescribed in these by-laws, and of such number as is fixed and determined in the articles of incorporation, which board of directors shall serve until the regular annual meeting of the stockholders and until their successors are elected and qualified. Each succeeding year thereafter there shall be elected a like number of directors at the annual meeting of the stockholders who shall serve for one year and until their successors are duly elected and qualified.

ARTICLE XXIV. REGULAR MEETINGS OF DIRECTORS.

The regular meeting of the board of directors shall be held at the offices of this company at the principal place of business thereof, on the second Monday of the months of January, April, July and August; if such be a legal holiday, then on the day following. In addition they shall meet regularly on the date of the organization and of the annual stockholders' meeting, immediately after said stockholders' meeting shall have adjourned. Regular meetings of the board of directors may be held at some place other than at the principal place of business of this corporation and may be held outside of the state creating this corporation, upon the affirmative vote of a full majority of the board of directors. In all cases where meetings shall have been held by the board of directors outside of the jurisdiction of the state creating this corporation, then

a certified copy of the records and minutes of such meeting shall be filed in the office at the principal place of business of this corporation.

ARTICLE XXV. SPECIAL MEETINGS OF THE DIRECTORS.

Special meetings of the board of directors may be held at any time at the principal place of business of this company, or may be held at any time or place by the unanimous consent of all the directors, which consent shall be executed by such directors and filed among the permanent records of this corporation. Special meetings may be called either by the president or board of directors, on the request of one-third of the members of the board of directors. The call and notice for all special meetings shall state the time, the hour, and the place of the holding of such meeting, and a clear description of the business to be transacted thereat. Each director of the corporation shall be entitled to a notice of the meeting, which shall be given by the secretary in writing at least five days preceding the date of such meeting.

ARTICLE XXVI. QUORUM.

A majority of the whole number of directors shall be necessary to constitute a quorum for the transaction of business. A majority of directors present and constituting such quorum shall be sufficient to determine any question or decide any matter brought before the board of directors. Whenever there is not a quorum present at any meeting of the board of directors, the directors present shall have a right to adjourn the meeting from time to time but shall have no right to transact any other business of any kind or character.

ARTICLE XXVII. CORPORATE SEAL.

The seal of the corporation shall be of such form as the directors of this corporation may adopt.

ARTICLE XXVIII. DIVIDENDS.

Dividends shall be declared by the board of directors of this corporation from the surplus profits arising from the business thereof. The directors of this corporation shall not make, declare or surrender dividends except from the surplus profits arising from the business of this corporation neither shall they divide, withdraw, or pay to the stockholders, or any of them, any part of the capital stock; nor shall they create debts beyond the subscribed capital stock of this corporation. For violation of the provisions of this section the directors under whose administration the same may have happened, excepting, of course, those who may have caused their dissent therefrom to be entered in the minutes of the directors at the time, or were absent from such meeting for good and sufficient cause are, in their individual and private capacity, jointly and severally liable to the corporation and the creditors thereof in the event of its dissolution to the full amount of the capital stock so divided, withdrawn, paid out or reduced, or debt contracted; and no statute of limitations is a bar to any suit against such directors for any sums for which they are made liable. There may, however, be a division or distribution of the capital stock of this corporation which remains after the payment of all its debts upon its dissolution or the expiration of its term of existence.

ARTICLE XXIX. REMOVAL OF DIRECTORS FROM OFFICE.

Directors who are unfaithful to their trust, or who shall fail, neglect or refuse to carry out the duties imposed upon them by the statute of the state, the charter of this corporation and these by-laws, may be expelled and removed from office by the stockholders of the corporation. However, no director shall be removed from office unless by a vote of stockholders

holding two-thirds of the capital stock, at a meeting held after previous notice of the time and place and of the intention to propose such removal. Meetings of stockholders for this purpose may be called by the president or by a majority of the directors or by members or stockholders holding at least one-half of the entire outstanding capital stock of the corporation. Such calls shall be in writing and addressed to the secretary who shall thereupon give notice of the time, place and objects of the meeting, and by whose order it is called. If the secretary fails to give the notice, or if there is none, the call may be addressed directly to the members or stockholders and be served as a notice, of annual meeting of stockholders, in which case, it must specify the time and place of meeting. In case of removal the vacancy shall be filled by the remaining directors.

ARTICLE XXX. RESERVE FUND.

The board of directors at their discretion may set aside not to exceed \$10,000 of and from the surplus earnings of the corporation as a reserve fund.

ARTICLE XXXI. AMENDMENTS.

These by-laws may be altered, amended or repealed at any meeting of the stockholders by a majority of the stock represented at such meeting. The directors shall have a right subject to the statute of the state, the charter of this corporation and the provisions of these by-laws to adopt additional by-laws in conformity herewith that may be necessary and proper for the proper purposes of this corporation, but they shall have no power to alter, repeal, or amend these by-laws, or any provision herein contained.

We, the undersigned, being all of the subscribers to the capital stock of the Amalgamated Traction Company, and all of the trustees named in the Articles of

incorporation of said company, hereby assent to the foregoing by-laws and adopt the same as the by-laws of this corporation.

C. O. BASSETT,

R. W. ATKINSON,

E. J. PETERSON,

J. RICHARD BROWN.

J. C. MOUNTAIN,

The Secretary then presented a written communication from Neil C. Bardsley offering to sell and convey to the company certain letters patent held by him to an improved gasoline engine, and to accept as payment in full therefor the entire capital stock of the corporation, excepting such shares as have heretofore been subscribed.

This communication having been read, it was, on motion duly made, seconded and unanimously carried, ordered recorded among the permanent records of the company, and a copy thereof spread upon these minutes, which copy is as follows, to-wit:

“November 3rd, 1911.

“Amalgamated Traction Company,

“Gentlemen:—

“I am the owner of letters patent No. 983,451, dated June 1, 1911, for an improvement on gasoline engines, the same being a valuable patent right.

“I hereby make you the following offer, to-wit: I will convey said letters patent and patent rights by good and sufficient conveyance, together with all my right, title and interest thereto, to your company, and accept in full payment therefor the entire capital stock of your company, excepting so much thereof as has heretofore been subscribed. If this offer is accepted, I will donate to the treasury of your company one thousand shares of said stock.^{2a}

“Neil C. Bardsley.”

^{2a} The property transferred in payment for the capital stock should always be described in this offer with reasonable accuracy.

The following resolution was then offered and un-animously adopted:

Whereas, Neil C. Bardsley has offered to sell to this company certain valuable letters patent in consideration of the issue of stock of this company, and

Whereas, it appears to the stockholders that such letters patent are necessary to the business of this company and are reasonably worth the par value for the number of shares of the stock of this company to be delivered therefor,

Therefore, Be It Resolved: That the Board of Directors of this Company be, and they hereby are, authorized and empowered in their discretion to purchase the said letters patent, and to issue, or cause to have issued, said stock in payment therefor, and

Be It Further Resolved: That we recommend the purchase of said letters patent in accordance with the terms of said offer.*

* We have heretofore called attention to the fact that the purpose of bringing this entire transaction before the subscribers of capital stock and the stockholders at this meeting is twofold. First: to provide the corporation with a working capital, which is the shares donated back to the corporation by Bardsley in his offer to the company, and, Second: power to make the stock of the corporation full paid under the law, and thus protect the future holders in actions for unpaid subscriptions.

There is, of course, another reason for this method of organizing corporations, and this is found in the fact that, usually, the property to be conveyed is either owned by the promoter of the corporation, or probably by one or more of its trustees, or controlled by options by one or more of these parties. The promoter and trustees, having an interest in the transaction by their ownership of the property, would not be competent to contract for the corporation without the consent of the stockholders and subscribers of the capital stock, and if such a contract were made, without such authority or ratification, it might, in after years, be annulled or set aside by the corporation or any of its objecting or dissenting stockholders.

Again, the law being settled in a number of states that subsequent purchasers of stock cannot complain of the frauds of directors or promoters, care is always taken to limit the officers of the

There being no further business to come before the meeting, the same was, on motion duly made, seconded and carried, adjourned.

_____,
Secretary.

_____,
Chairman.

corporations to persons under the direct control of the promoters and the directors, so that the records of the corporation will show that all of the subscribers to the capital stock and stockholders were parties to the transaction and consented to and voted for the same. *Hawes v. Contra Costa Water Co.*, 104 U. S. 450, 26 L. Ed. 827; *Home Fire Ins. Co. v. Barber*, 67 Neb. 644, 60 L. R. A. 927, 93 N. W. 1024, 108 Am. St. Rep. 716; *Clark v. Am. Coal Co.*, 86 Ia. 436, 53 N. W. 291, 17 L. R. A. 557. *Contra*: *Pollitz v. Gould*, 202 N. Y. 11, 94 N. E. 1088, 38 L. R. A. (N. S.) 988; *Just v. Idaho, etc. Co.*, 16 Idaho, 639, 102 Pac. 381, 133 Am. St. Rep. 140; *Morawetz on Private Corporations* (2nd Ed.), sec. 265.

Thus, in after years, should stockholders undertake to recover secret profit of the promoters, or rescind the contract by reason of the fact that the directors had a personal interest in the transaction, they would be promptly met with the defense that all stockholders had consented to the transaction, and that they, as subsequent purchasers of stock, could not complain.

This is the important reason why the organization meeting should be called and held with strict compliance to the statute of the state wherein the corporation is created, as very often, in after years, this meeting, for the reasons just stated, will be assailed from every conceivable standpoint.

So, too, it is the law in a number of jurisdictions that corporate creditors, who contract with, or extend credit to, the corporation with full knowledge that the stock has not been fully paid, or paid with property at an overvaluation, or sold for cash below par, cannot complain or enforce liability, even though the property purchased was grossly and wilfully overvalued.

For these reasons, it has been found advisable to set forth in the records of the organization meeting of the corporation, where all of the subscribers of capital stock and the trustees or directors, as named in the articles of incorporation, are present and represented, the entire transaction from beginning to end, that the subsequent purchasers of stock or the corporate creditors may have an opportunity, by examining the books of the corporation, to ascertain its exact condition.

MINUTES OF THE FIRST DIRECTORS' MEET-
ING OF THE AMALGAMATED TRACTION
COMPANY, HELD AT THE CITY OF
——, STATE OF ——,
(DATE)

The first meeting of the Board of Directors of the Amalgamated Traction Company was held at its office in the City of ——, State of ——, in pursuance to Article No. 24 of the by-laws,¹⁰ immediately following the adjournment of the organization meeting.

J. Richard Brown was chosen as Chairman, and presided over the meeting; William Randolph Nutter was elected as Secretary, and acted as Recording Officer.

All the directors were present in person, and subscribed to the following oath of office:

STATE OF ——, }
County of ——, } ss.

C. O. BASSETT, E. J. PETERSON, J. C. MOUNTAIN, R. W. ATKINSON and J. RICHARD BROWN, being duly sworn, on oath says, each for

The statutes of Montana require that at the meeting at which the by-laws are adopted, or at such subsequent meeting as may be then designated, directors must be elected to hold their office for one year, and until their successors are elected and qualified. The statutes of that state also require that, within one month after filing articles of incorporation, the corporation must adopt a code of by-laws for its government, not inconsistent with the constitution and laws of the state.

¹⁰ It is to be noted here that under the by-laws as adopted by this corporation provision is made for the directors' meeting, immediately after the regular annual meeting of the stockholders. In the absence of such by-law provision, it will probably be necessary for the directors to sign a written call and waiver, very similar to that signed by the incorporators and trustees in calling the organization meeting of the stockholders. In which event the record as heretofore made in the organization should be followed in the trustees' meeting.

himself, and not one for the other; That he is one of the duly constituted directors of the Amalgamated Traction Company, and a stockholder therein; that by the articles of said corporation he was constituted as and for one of the directors of said corporation for a period of not to exceed ——— months from the date of its incorporation; that during the time for which he was, and is, appointed as such director, and during all the time he continues so to act, he will support and obey the constitution and laws of the State of ———, the charter and by-laws of said corporation; that he will at all times carry out and perform all duties assigned to him by, and through, said articles and the by-laws adopted by said corporation, and will at all times, while acting as such director, transact all the business for said corporation to the best of his ability, and for the best interest of the corporation and its stockholders.

C. O. BASSETT,

R. W. ATKINSON,

E. J. PETERSON,

J. R. BROWN.

J. C. MOUNTAIN,

Subscribed and sworn to before me this 3rd day of November, 1911.

Neil C. Bardsley.

Notary Public in and for the State
of ———, residing at ———.

The first order of business was the election of officers. The following named persons were duly and regularly elected, in the manner and form as provided by the by-laws, to-wit:

President: J. Richard Brown,

Vice-President: C. O. Bassett,

Secretary: W. A. Peterson,

Treasurer: E. J. Peterson,

General Manager: George J. Engert,

Auditor: William Randolph Nutter,
General Counsel: H. N. Martin.

All of the above named officers being present, each subscribed to an oath of office.

The Secretary then presented a form of stock certificate, a copy of which is as follows:

Incorporated under the laws of the State of _____.
No. _____ Shares.

AMALGAMATED TRACTION COMPANY

Fully paid with property Capital Stock \$200,000.00
Non-Assessable

THIS CERTIFIES that _____ is the owner
of _____ shares of the capital stock of

AMALGAMATED TRACTION COMPANY

transferrable only on the books of the corporation by
the holder hereof in person or by attorney upon sur-
render of this certificate properly endorsed.

IN WITNESS WHEREOF, the said Corporation
has caused this certificate to be signed at _____ (city),
_____ (state), by its duly authorized officers, and to be
sealed with the seal of the corporation this _____ day
of _____, A. D. 191-.

_____,
Secretary

_____,
President.

S H A R E S

Par Value

One Hundred Dollars

E A C H.

Which form of certificate was, on motion duly made,
seconded and carried, adopted and approved.

The Secretary then presented a written communica-
tion from Neil C. Bardsley offering to sell and convey
to the company certain letters patent held by him to
an improved gasoline engine, and to accept as payment
in full therefor the entire capital stock of the corpora-

tion, excepting such shares as have heretofore been subscribed for.

This communication, having been read, was, on motion duly made, seconded and unanimously carried, ordered recorded among the permanent records of the company, and a copy thereof spread upon these minutes, which copy is as follows, to-wit:

“November, 3rd, 1911.

“Amalgamated Traction Company,

“Gentlemen:—

“I am the owner of letters patent No. 983,451, dated June 1, 1911, for an improvement on gasoline engines, the same being a valuable patent right.

“I hereby make you the following offer, to-wit: I will convey said letters patent and patent rights by good and sufficient conveyance, together with all my right, title and interest thereto, to your company, and accept in full payment therefor the entire capital stock of your company, excepting so much thereof as has heretofore been subscribed. If this offer is accepted, I will donate to the treasury of your company one thousand shares of said stock.

“Neil C. Bardsley.”

The following resolution was then offered and unanimously adopted:

Whereas, Neil C. Bardsley has offered to sell to this company certain valuable letters patent in consideration of the issue of stock of this company, and

Whereas, it appears to the directors that such letters patent are necessary for the business of the company, and are reasonably worth the par value of the number of shares of the stock of this company to be delivered therefor, and

Whereas, the stockholders have recommended the purchase of said letters patent, in accordance with the terms of said offer,

Now, Therefore, Be It Resolved: That the offer of Neil C. Bardsley, above referred to, be, and the same hereby is, accepted, and the President and Secretary are authorized, instructed and empowered to accept from said Neil C. Bardsley a proper conveyance, vesting in this company all right, title and interest in and to said letters patent, and to execute and deliver, upon the receipt of such conveyance, the entire capital stock of the company, excepting such shares as have heretofore been subscribed, and to receive from said Neil C. Bardsley one thousand, (1,000), shares of said stock, which shall be designated as treasury shares of the company.

Motion duly made, seconded and carried, authorizing and instructing the treasurer to pay from the funds of the corporation all necessary expenses connected with the incorporation of the company.

Motion duly made, seconded and carried, authorizing the secretary to purchase all necessary stock books, stock ledgers, seal, books for corporate records and all necessary supplies needed by the corporation, and instructing the treasurer to pay for the same.

Motion duly made, seconded and carried, authorizing and empowering the president to rent such offices as in his judgment shall be convenient and proper for the use of the company, at a rental of not to exceed \$2,000 per annum, and to make such lease as may be necessary for not to exceed five years.

Motion duly made, seconded and carried, authorizing and instructing the proper officers of the company to cause to be printed such prospectuses and literature as shall be deemed necessary in promoting the sale of the treasury stock of the corporation, which prospectuses and literature shall not cost to exceed \$5,000.

The following resolution was then offered and unanimously adopted:

Whereas, there is in the treasury of the company one thousand, (1,000), shares of stock, which has heretofore been fully paid and donated to the corporation for the purpose of promoting the interests of the corporation, and

Whereas, it is impossible to sell and dispose of such stock at the par value thereof, and

Whereas, it is necessary to sell and dispose of such stock immediately,

Now, Therefore, Be It Resolved: That said one thousand, (1,000), shares of the treasury stock of this company be offered for sale at fifty dollars per share, and the officers of the company are hereby authorized and instructed to issue to any person, or persons, certificates of stock for such number of shares as may be purchased at said price.

Motion duly made, seconded and carried, fixing the salaries of the president at \$600 per year; general manager \$1,200 per year; secretary \$750 per year; treasurer \$500 per year; auditor \$300 per year; general counsel \$1,000 per year, and authorizing the treasurer of the company to pay said amounts monthly from the funds of the company, until the further order of this board.

On motion duly made, seconded and carried, the bond of the treasurer was fixed at \$10,000 and was immediately furnished by the treasurer, together with good and sufficient surety, and was approved by the Board of Directors.

There being no further business to come before the meeting, the same was, on motion duly made, seconded and carried, adjourned until the next regular meeting of the board.¹¹

Secretary.

¹¹ The statutes of California, Idaho and Montana require all corporations for profit to keep a record of all their business transac-

The organization of the corporation having been completed, and the directors having subscribed to the oath and assumed the duties of their offices, and the officers having been elected, care should be taken to record all of the corporate acts in the manner and form prescribed in the by-laws and statutes.

STOCKHOLDERS' MEETING.

The next important step will be the holding of the first annual stockholders' meeting. The call for this meeting should be prepared and published in the manner provided for in the by-laws. The meeting will then be held in pursuance to this call, and the records will appear as follows:

MINUTES OF THE REGULAR ANNUAL STOCKHOLDERS' MEETING OF THE AMALGAMATED TRACTION COMPANY

held at (city) ———, State of ———, the 1st day of August, 1911.

The stockholders of the Amalgamated Traction Company met on this 1st day of August, 1911, at the of—

tions; a journal of all meetings of their directors, members or stockholders, with the time and place of holding the same, whether regular or special, and if special, its object, how authorized, and the notice thereof given. The record must embrace every act done, or ordered to be done; who were present, and who absent; and, if requested by any director, member or stockholder, the time shall be noted when he entered the meeting or obtained leave of absence therefrom. On a similar request, the ayes and noes must be taken on any proposition, and a record thereof made. On a similar request, the protest of any director, member, or stockholder, to an action or proposed action, must be entered in full—all such records to be open to the inspection of any director, member, stockholder, or creditor of the corporation.

Under these statutes the minutes of the meetings of the board of directors and stockholders should always be in writing and carefully preserved.

fice of the Company in the City of ———, State of ———, in pursuance to a notice published according to the provisions of the by-laws.

The meeting was called to order by J. Richard Brown, President; W. A. Peterson, secretary of the company, acted as recording officer.

The President announced the objects and purposes of holding the meeting.

The Secretary then produced the call pursuant to which the meeting was held, together with proper and necessary proof that the call had been published in the ———, a newspaper of general circulation, published in ———, ——— County, State of ———, for a period of more than ——— days next preceeding the date of this meeting; the call was then read, and, on motion duly made, seconded and carried, was accepted and ordered recorded among the permanent records of the corporation, and is as follows, to-wit:

“NOTICE TO STOCKHOLDERS.

“Notice is hereby given that the regular annual meeting of the stockholders of the AMALGAMATED TRACTION COMPANY will be held at the principal place of business of the corporation, to-wit: No. 20 Broad Street, ———, County of ———, State of ———, on the 1st day of August, 1911, at the hour of 2:30 o'clock, P. M., for the purpose of electing directors for the ensuing year, and for the transaction of such other and further business as may properly come before the meeting.

“W. A. Peterson, Secretary.

Corcoran v. Sonora Min. & Mill. Co., 8 Idaho, 651, 71 Pac. 127;
Ruck v. Caledonia Silver Min. Co., 6 Cal. App. 356, 92 Pac. 194.

Even in those states where there are no statutory provisions similar to those above noted, the records of the meetings of the directors and stockholders should always be in writing, prepared in proper form, and recorded among the permanent records of the corporation.

"Dated at ———, ———, this ——— day of (date as provided by statute or by-laws) ———, 1911."

The Secretary then produced proper proof that the notice had been regularly given as by the by-laws provided.

The President then announced as the first order of business the roll call, in order to determine whether or not a quorum was present. The Secretary then proceeded to call the roll, and the following named persons, representing the number of shares set opposite their respective names, were found to be present in person at the meeting:¹²

J. Richard Brown.....	100	shares
E. J. Peterson.....	100	"
S. S. Bassett.....	100	"
Neil C. Bardsley.....	100	"
R. W. Atkinson.....	100	"
W. A. Peterson.....	100	"
W. R. Nutter.....	100	"
C. R. Jones.....	100	"

Total 800 "

The following named persons, owning the number of shares set opposite their respective names, were represented by proxies as follows:

N. A. Peterson 100 shares by proxy E. J. Peterson.
 Geo. J. Engert 100 shares by proxy C. O. Bassett.
 C. R. Hesseltine 100 shares by proxy S. S. Bassett.

¹² Several of the states, including New Jersey, Delaware and New Mexico, require the secretary to make a full, true and complete list, in alphabetical order, of all the stockholders entitled to vote at the ensuing election, with the residence of each. The list to be at all times in the principal office, and open to inspection and examination, during the usual business hours, by any stockholder.

The total number of shares represented in person and by proxy at the meeting being 1100 shares, which amount totals more than one-half of the total number of outstanding shares of the corporation, and constituted a quorum for the transaction of business.¹³

On motion duly made, seconded and carried, the minutes of the organization meeting, as well as the minutes of the previous meetings of the board of directors, were read and approved.

The by-laws, adopted at the organization meeting, were read section by section, and, after some discussion, were, by unanimous vote, adopted as the by-laws of the corporation, and the action of the incorporators and subscribers to the capital stock in adopting said by-laws at the organization meeting was, by unanimous vote, ratified and approved.¹⁴

The President then submitted his first annual report in writing, reviewing generally the history of the corporation, the progress made, and the condition thereof; which report was, on motion duly made, seconded, and carried, accepted and ordered recorded.

The general manager then submitted his report of

¹³ The secretary should always be prepared for the holding of the annual stockholders' meeting. An alphabetical list of the shareholders should be prepared several days before the meeting is held. We recommend the use of a tally sheet, similar to the following:

Name	No. Shares	Present in person	Proxy held by
J. A. Anderson.....	100	No	Absent
J. R. Brown.....	100	Yes	
Geo. J. Engert.....	100	No	S S. Bassett

¹⁴ In most of the states a motion of this character is unnecessary. It is suggested here by reason of the fact that a few of the eastern states have statutes providing that the by-laws shall be adopted by the stockholders, and, this being the first stockholders' meeting, to eliminate any possible doubt, we recommend the re-adoption of the by-laws, as above suggested.

the progress made by the corporation for the year last past, which report was, on motion duly made, seconded and carried accepted and ordered recorded.

The treasurer submitted his report, showing the financial condition of the company, together with certain recommendations, which report, after having been read, was, on motion duly made, seconded and carried, accepted and ordered recorded.

The Secretary presented his report, which, after having been read, was accepted and ordered recorded.

The Auditor made a full and complete report, which report after having been read, was accepted and ordered recorded.

The president then announced as the next order of business, the election of five directors to manage and control the affairs of the corporation for one year and until their successors were duly elected and qualified. The following named persons were nominated: C. O. Bassett, E. J. Peterson, J. R. Brown, R. W. Atkinson and W. Randolph Nutter.

The election was by ballot, and all persons present voted all shares of stock represented by them. They, and each of them, were duly and regularly elected as directors, and the result of the election was announced by the president. Immediately after the election of the board of directors, the directors qualified by taking the usual oath of office.¹⁵

There being no further business to come before the meeting, the same was, on motion duly made, seconded and carried, adjourned.

Secretary.

¹⁵ See form No. 5.

No. 1.

PROXY.

Simple form.

KNOW ALL MEN BY THESE PRESENTS, That I, the undersigned a stockholder in the Amalgamated Traction Company, hereby and by these presents make, constitute, and appoint J. T. Mulligan, of _____, _____ County, _____, my true and lawful attorney and proxy for me in my name, place, and stead to vote all shares of stock owned by me in the said company at the annual meeting of the stockholders to be held on the 1st day of August, 1911, for the election of five directors of said corporation.

WITNESS my signature this _____ day of _____, _____.

Witnessed, _____.

No. 2.

PROXY.

Intermediate form.

KNOW ALL MEN BY THESE PRESENTS, That I, the undersigned, a stockholder in the Amalgamated Traction Company hereby and by these presents make, constitute and appoint J. T. Mulligan, of _____, _____, my true and lawful attorney and proxy with full power of substitution for me and in my name, place, and stead to vote on all questions presented at the annual stockholders' meeting of said company to be held in the city of _____, _____, on the 1st day of August, 1911, and any adjournment thereof, with all the powers I should possess if personally present.

WITNESS my signature this _____ day of _____, _____.

Witnessed, _____.

No. 3.

PROXY.

Comprehensive form.

KNOW ALL MEN BY THESE PRESENTS, That I, the undersigned, a stockholder in the Amalgamated Traction Company, hereby and by these presents make, constitute and appoint J. T. Mulligan, of _____, _____, my true and lawful attorney with full power of substitution for me and in my name, place and stead, to vote upon all shares of stock owned and held by me, and to represent me fully at all meetings, regular or special, of the stockholders of said corporation. Hereby giving to my said attorney all the powers that I would possess if personally present at any of such meetings. By these presents ratifying and confirming each and all of the acts done by my said attorney hereby appointed.¹⁶

Witness.

¹⁶ We give here three forms of proxy. The first, or simplest form as will be noted is limited to voting for five directors at the annual stockholders' meeting held on a particular date. This power of attorney expires of its own motion immediately upon the adjournment of the annual stockholders' meeting named and designed therein. The holder of this proxy has no authority to vote upon any questions presented to the consideration of the meeting except the election of five directors.

We have heretofore suggested that a proxy is nothing more or less than a simple, concise power of attorney; therefore the only powers conferred upon a person holding such proxy are the powers expressly designated therein, or directly incident to those express powers. As the simple form of proxy expires of its own motion, no express revocation is necessary unless the giver of such proxy desires some one else to represent him at the meeting.

The second form given as will be noted confers authority upon the holder thereof to vote not only for the election of directors at the stockholders' meeting, but also upon all questions properly brought before such meeting. It is to be noted however that this proxy is limited to the particular meeting designated therein and after an

OATH OF TEMPORARY DIRECTORS.

Named in the Articles of Incorporation.

STATE OF _____, } ss.
County of _____.

C. O. Bassett, J. C. Mountain, E. J. Peterson, J. R. Brown and R. W. Atkinson, being duly sworn, on oath says, each for himself and not one for the other, that he is one of the duly elected trustees for the Amalgamated Traction Company, organized under the laws of the State of _____, with its principal place of business located at _____, _____.

That he is one of the incorporators of the said corporation and is a stockholder therein. That by the articles of incorporation, he was selected and designated as one of the trustees in and for said corporation for a period of not to exceed six months from the date of its incorporation.

That during the time for which he was and is appointed as trustee and during all the time he continues so to act as trustee of said corporation, he will support and obey the constitution and laws of the United States, and the constitution and laws of the state of incorporation, charter and the by-laws of the said corporation.

adjournment of this meeting, this proxy will expire of its own motion. Of course, the presence of the owner of the stock, and the giver of the proxy, at the stockholders' meeting, would ipso facto revoke the proxy.

The third form given here, or comprehensive form, gives to the holder thereof the power of representing the stockholder in any and all meetings, regular or special, of the corporation and to vote at such meetings on all shares of stock standing in such person's name on the books of the corporation, and on all matters presented to the consideration of the meeting. This proxy in most states will be good until it is revoked by the stockholder. Revocation should be in writing, filed with the secretary of the corporation, although in most cases, this is not absolutely necessary.

That he will at all times carry out and perform all duties assigned to him by and through said articles of incorporation and the by-laws adopted by said corporation and will at all times while acting as said trustee transact all the business for said corporation to the best of his ability and for the best interests of the corporation and its stockholders.

C. O. BASSETT,
J. C. MOUNTAIN,
E. J. PETERSON,

J. R. BROWN,
R. W. ATKINSON.

Subscribed and sworn to before me this 18th day of April, 1911.

Notary Public in and for the State
of _____, residing at _____.

OATH OF DIRECTORS.

Elected at Stockholders' Meeting.

STATE OF _____, }
County of _____. } ss.

C. O. Bassett, J. C. Mountain, E. J. Peterson, J. R. Brown and R. W. Atkinson, being duly sworn on oath says, each for himself and not one for the other, that he is a duly elected and appointed trustee in and for the Amalgamated Traction Company, organized under and by virtue of the laws of the State of _____, with its principal place of business located at _____.

That he is one of the directors of the said corporation and is a stockholder therein. That he was elected and selected as a director in said corporation in a duly

This form of proxy is given where the shareholder desires that his attorney shall represent him from time to time for an uncertain period. It is not necessary that the proxy be acknowledged. It should, however, be witnessed by at least one witness. It will always be filed with the secretary in accordance with the terms of the by-laws of the corporation. Attention has heretofore been called to statutes limiting the life of a proxy. A number of states have such statutes.

and regularly called annual stockholders' meeting, which had been called and held in accordance with the laws of the State of ——— and the by-laws of the said corporation.

That during the time for which he was and is elected as said director, and during all the time he continues to act as a director of said corporation, he will support and obey the constitution and laws of the United States and the constitution and laws of the State of ———, the articles of incorporation, and by-laws, as now in force or may hereinafter be adopted by said corporation.

That he will perform all the duties assigned to him incident to the said office and will transact all business relative thereto according to law and to the best of his ability for the best interests of the corporation and its stockholders.

C. O. BASSETT,

J. R. BROWN,

J. C. MOUNTAIN,

B. W. ATKINSON.

E. J. PETERSON,

Subscribed and sworn to before me this ——— day of

———, ———.

Notary Public in and for the State
of ———, residing at ———.

OATH OF OFFICE FOR PRESIDENT.

STATE OF ———, }
County of ———. } ss.

J. R. Brown being first duly sworn on oath says; That he is one of the stockholders of the Amalgamated Traction Company and that at a regular meeting of the board of trustees of said corporation called and held in accordance with the laws of the State of ——— and the adopted by-laws of the said corporation, he was duly and regularly elected and appointed to the

office of president. During all the time of holding said office he will support the constitution and laws of the United States and the laws and constitution of the State of ———, the Articles of Incorporation and by-laws of said corporation and will at all times faithfully and diligently perform and carry out the duties of said office as prescribed by law and by the by-laws of the said corporation to the best of his ability.¹⁷

J. R. Brown.

Subscribed and sworn to before me this — day of
———, ———.

Notary Public in and for the State
of ———, residing at ———.

ASSIGNMENT OF STOCK.

FOR VALUE RECEIVED, I hereby sell, assign and transfer unto Richard A. Wright One-Thousand (1000) Shares of the Capital Stock represented by the within Certificate, and do hereby irrevocally constitute and appoint (the secretary or other proper officer of said company) to transfer the said Stock on the books of the within named Company with full power of substitution in the premises.

WITNESS, my hand and seal this — day of
———, ———.

In Presence of:

J. R. Brown.

W. A. PETERSON.

¹⁷ The form of oath given here for the president of the corporation can be used by all of the other officers by simply designating therein the officer subscribing to the oath. Thus, where the president appears, if the oath is being used for the vice-president, the change will be designated in the oath and so on for all the officers of the corporation.

While it may not be absolutely necessary for the officers to take an oath of office, it is always advisable and should be encouraged and required by all corporations.

BOND OF TREASURER.

KNOW ALL MEN BY THESE PRESENTS, That we, E. J. Peterson, as principal and J. R. Brown and W. R. Nutter, as sureties all of whom are actual residents of the State of —— are held and firmly bound unto the Amalgamated Traction Company, a corporation organized under and by virtue of the laws of the State of ——, in the sum of Ten-Thousand Dollars (\$10,000) lawful money of the United States of America to be paid unto the said Amalgamated Traction Company, or their successors in interest for which payment well and truly to be made we bind ourselves, our heirs, executors and administrators firmly by these presents. Sealed with our seals and dated this —— day of ——, ——.

The conditions of this obligation are such that whereas said E. J. Peterson has on this day been duly and regularly elected and qualified treasurer of the Amalgamated Traction Company and desires to enter upon the duties of said office, and whereas he will as such treasurer receive into his hands and keep in his possession for said corporation money, goods and chattels for which he shall be bound to properly account to said corporation and the whole thereof and to surrender to said corporation at the expiration of the term of his office all money, goods, and property received by him for said corporation during his incumbency as treasurer and to peaceably surrender all books, records and documents in his possession.

NOW THEREFORE, if the said E. J. Peterson shall in all respects fully and faithfully discharge his duty as such treasurer and shall keep true, accurate and just accounts of all money, goods and property coming into his possession as treasurer of said cor-

poration and shall make to said corporation a full, true and accurate account of all moneys received and disbursements made by him during his term of office, and shall at the expiration of said term deliver and surrender to said corporation all moneys, goods, property of whatsoever kind and character rightfully belonging to said corporation, and shall in all respects fully and faithfully discharge his duties as required by the statute of the state and charter, by-laws and rules and regulations of the corporation, then this obligation shall be void, otherwise it shall be and remain in full force and effect.

WITNESS our signatures this — day of —, —.

E. J. PETERSON,
J. R. BROWN,
W. R. NUTTER.

STATE OF —, }
County of —. } ss.

J. R. Brown and W. R. Nutter whose names are subscribed to the above and within bond as sureties, being severally duly sworn, each for himself, deposes and says that he is a resident and free holder of the State of —. That he is worth the amount for which he has become surety on the within and above bond over and above all just debts and liabilities in unincumbered property situated within the State of —, exclusive of property exempt from execution.

J. R. BROWN,
W. R. NUTTER.

Subscribed and sworn to before me this — day of —, —.

Notary Public in and for the State
of —, residing at —.

BOND.

For lost or destroyed certificates.

KNOW ALL MEN BY THESE PRESENTS, That J. R. Brown as principal and John Hamilton and John Will as sureties are held and firmly bound unto the Amalgamated Traction Company, a corporation organized and existing under and by virtue of the laws of the State of ———, with its principal place of business located at ———, ———, ———, in the sum of Five-Thousand Dollars, (\$5,000) lawful money of the United States of America to be paid to the said corporation or its successors in interest for which payment well and truly to be made we bind ourselves, our heirs, executors, and administrators jointly and severally by these presents.

Sealed with our seals and dated this ——— day of ———, ———.

The conditions of the above bond and obligation are such that whereas the above corporation duly and regularly issued to the above named J. R. Brown a certain certificate representing Three-Hundred (300) shares, par value of \$100 each, of the capital stock of the Amalgamated Traction Company, which certificate was numbered 25, and dated at ———, ——— on the ——— day of ———, ——— and whereas said certificate is now alleged to have been destroyed or lost and the owner thereof to-wit, J. R. Brown, the principal in this bond, desires the issuance of a new certificate in lieu thereof, and whereas, the board of directors of said corporation have ordered that a new certificate be issued in lieu of such lost certificate on condition that the owner thereof shall give the corporation a bond in the sum of Five-Thousand (\$5,000) Dollars as indemnity against any claim that may be made against such corporation.

NOW THEREFORE, if the obligor, the said J. R. Brown or his heirs, executors, or administrators shall at all times hereinafter well and truly save and keep the said Amalgamated Traction Company, and its successors in interest harmless of and from all actions, loss, damages, and attorney fees, of and from, by reason of, or growing out of the above described certificate of stock, and shall well and truly repay to the said Amalgamated Traction Company, or its successors in interest on demand any and all sum or sums of money that it may be required to pay in any way, manner or form connected with the above described lost certificate of stock, then this obligation shall be void, otherwise to remain in full force and effect.

WITNESS, our signatures this ____ day of _____,

J. R. BROWN,
JOHN HAMILTON,
JOHN WILL.

STATE OF _____, }
County of _____. } ss.

John Hamilton and John Will, whose names are subscribed to the above and within bond, as sureties being severally duly sworn each for himself deposes and says that he is a resident and freeholder of the State of _____. That he is worth the amount for which he has become surety on the within and above bond over and above all just debts and liabilities in unincumbered property situated within the State of _____, exclusive of property exempt from execution.

JOHN HAMILTON,
JOHN WILL.

Subscribed and sworn to before me this ____ day of _____,

Notary Public in and for the State
of _____, residing at _____.

BILL OF SALE.

KNOW ALL MEN BY THESE PRESENTS, That the Amalgamated Traction Company, a corporation organized and existing under and by virtue of the laws of the State of ———, with its principal place of business located in the City of ———, ———, in consideration of the sum of Five-Hundred (\$500) Dollars to it in hand paid, the receipt whereof is hereby acknowledged, does hereby grant, bargain and sell to F. C. Burns the following described personal property, to-wit:

One bay horse, named "Jack," weight about 1100 lbs. and branded B. on the left hip and one gray horse, named "Jip," weight about 1150 lbs., branded with letter L. on the right hip.

TO HAVE AND TO HOLD ALL and singular the said premises unto the said F. C. Burns, and to his heirs and assigns forever.

IN WITNESS WHEREOF, the said Amalgamated Traction Company, has caused these presents to be executed by its president and attested by its secretary, and the corporate seal to be hereunto affixed on this ——— day of ———, ———.

THE AMALGAMATED TRACTION COMPANY.

By J. B. Brown
President.

Attest:

W. A. Peterson
Secretary.

POWER OF ATTORNEY,

To sell corporate stock.

KNOW ALL MEN BY THESE PRESENTS, That the Amalgamated Traction Company, a corporation organized under and by virtue of the laws of the State

of ———, with its principal place of business located at ———, ———, ———, does by these presents make, constitute and appoint Chas. Hall of ———, ———, ——— its true and lawful attorney for its and in its name, place and stead to grant, bargain, sell, assign and transfer 100 shares of the capital stock of the said corporation at \$50.00 per share. One-half to be paid in cash at the time the certificates of stock are delivered to the purchaser and the balance thereof on such date as in his judgment seems right and proper. Said attorney shall have a right to collect and receive all money due on the said stock. He shall also have the right to deliver to the purchaser of said stock certificates representing the number of shares sold to such person or persons. Also to enter into all such lawful contracts and agreements with reference to the sale of said stock as to him seem meet and just under all the circumstances. Hereby giving attorney the same rights and powers with reference to the sale of said stock and receiving the money therefore as this corporation would have itself.

IN WITNESS WHEREOF, the said Amalgamated Traction Company, has caused these presents to be executed by its president and attested by its secretary, and its corporate seal to hereunto affixed on this ——— day of ———, ———.

THE AMALGAMATED TRACTION COMPANY,

By J. R. Brown,
President.

Attest:

W. A. Peterson,
Secretary.

CALL FOR STOCKHOLDERS' MEETING.

To increase Capital Stock.

To the stockholders of the Amalgamated Traction Company:

NOTICE IS HEREBY GIVEN, that a meeting of the stockholders of the Amalgamated Traction Company, a corporation organized under the laws of the State of ———, with a capital stock of 2,000 shares of the par value of \$100 each, has been called by order of the board of trustees of the said corporation to-wit: in the City of ———, ——— County, ———, on the ——— day of ———, ———, at the hour of ——— o'clock (P. M.) for the purpose of considering and acting upon a resolution to increase the amount of the capital stock of the said corporation, and that at such meeting it is proposed to increase the amount of such stock to ——— shares of the par value of \$ ——— each, inclusive of its present capitalization.

IN WITNESS WHEREOF, we the majority of all the trustees of the said corporation have hereunto set our hands and seals on this ——— day of ———, ———.

R. B. COLEMAN,

J. K. HARDING,

C. R. DILWORTH.

Trustees.

NOTICE OF STOCKHOLDERS' SPECIAL MEETING.

To the Stockholders of the Amalgamated Traction Company.

NOTICE IS HEREBY GIVEN, That in accordance with the written request of the majority of the directors of the company as prescribed in the by-laws, a

special meeting of the stockholders of the Rocky Mountain Mining Company is hereby called and will be held at the principal place of business of the corporation, to-wit:—(Place of Business) ———, ———, ——— County, ———, at the hour of ——— o'clock (P. M.) on the ——— day of ———, ———.

The nature of the business to be transacted at said stockholders' special meeting is to authorize the sale of the Comstock quartz Lode Mining claim which claim is now owned and held by said corporation and the further authorization of all acts necessary and proper to execute and deliver all necessary instruments in writing, to convey good and sufficient title to said claim.

By order of the board of trustees.

J. R. Brown
President.

W. A. Peterson
Secretary.

SUBSCRIPTION TO CAPITAL STOCK.

We, the undersigned hereby severally subscribe for and by these presents purchase the number of shares set opposite our respective names in the Amalgamated Traction Company to be organized under the laws of the State of ——— with a capitalization of \$200,000 divided into 2,000 shares of the par value of \$100 each and agree to pay for the same to said corporation at the rate of \$100 per share, as soon as the same is organized.

F. J. YERKES.....	3 shares
W. J. TURNER.....	3 shares
B. F. MURRAY.....	4 shares

OBJECT AND PURPOSE CLAUSES.

MINING AND SMELTING.

The objects and purposes for which the corporation is formed are and shall be to conduct and carry on a general mining, smelting, milling and building business in the State of ——— and all other states and territories of the United States; to locate, patent, acquire, purchase, own, hold, lease, sell, occupy, use or develop any lands or properties containing gold, silver, copper, tin, lead, iron or other metals or combination of metals, and to locate, acquire, purchase, own, hold, sell, lease, mortgage, improve, use and occupy mill sites, tunnel sites, and land and property of every description convenient, proper or necessary for the proper use of this corporation; to locate, patent, acquire, buy, own, sell, hold, lease, mortgage or encumber mines and mining properties of every description, and to operate and develop the same; to mine or otherwise extract or remove from mines and mining claims all valuable ores, minerals or mineralized rock; to purchase, construct, acquire, own, hold, lease, mortgage, sell, use and operate smelters, concentrators, stamp-mills, reduction plants and all kinds of machinery, plants and apparatus used in the business of mining, reducing, smelting and refining of the products of mines, and to treat, smelt and refine all kinds of ores, minerals or mineralized substances, and prepare the same for market generally; to engage in smelting, reducing, treating, milling and refining of ores, minerals and mineralized rock of every kind and description; to acquire, buy, purchase or otherwise, own, hold, use, lease, sell, mortgage and encumber timber land, timber tracts and rights; to acquire, own.

hold, sell, lease, mortgage and operate saw mills, planing mills, shingle mills and all other kind of mills for the making and manufacturing of lumber for the use of the company; to appropriate, locate, acquire, sell, lease, mortgage, improve, develop and use water rights, water powers, water privileges and appropriations of every kind and character, and to erect, maintain, construct, acquire, sell, mortgage and use canals, ditches, flumes, pipe lines, tunnels, tanks, reservoirs, dams, buildings, plants, machinery, fixtures and apparatus of every kind necessary, proper or convenient to develop and furnish power; to build, acquire, purchase, own, hold, sell, lease, mortgage, and operate buildings and machinery necessary for the generation and distribution of electric power; to construct, purchase, own, hold, lease, sell, mortgage and operate lines and wires and all appurtenances and appendages necessary, proper and convenient to transmit such electric power, and to sell and lease electric power to others; to build, construct, acquire, purchase, own, hold, lease, sell, mortgage, improve and operate tramways of every kind and nature, together with all necessary and proper appurtenances and appliances therefor; to acquire, hold or dispose of stock, bonds or other obligations of any corporation formed for the purpose of carrying out any of the kind of business, object or purposes above indicated, and to issue and use stock, bonds or other obligations in the payment for such property, stock or bonds, and to issue and use stock, bonds or other obligations of the corporation for any object or purpose in connection with any of its business, engagements, or promotion of its affairs.

MANUFACTURING.

The objects and purposes for which the corporation is formed are and shall be to carry on a general manufacturing business in the State of —— and all other states and territories of the United States, to purchase, acquire, own, lease, sell, occupy, use and develop any lands necessary for the business of the corporation; to purchase, acquire, own, hold, lease, sell, mortgage and operate manufacturing plants, equipment, engines and machinery, and to manufacture from raw material, buy, sell, deal in, handle and export all kinds of manufactured articles; to acquire, own, hold, use and dispose of any and all properties, assets, stock, bonds and rights of any and every kind; to borrow money and issue notes, mortgages, bonds, debentures and any evidence of indebtedness; to apply for, obtain, register, purchase, lease or otherwise to acquire and to hold, use, own, operate and introduce and to sell, assign or otherwise dispose of trade marks, trade names, patents, inventions, improvements and processes used in connection with or secured under letters patent of the United States, or elsewhere, or otherwise; and to use, exercise, develop, grant licenses in respect of, or otherwise turn to account any such trademarks, patents, licenses, processes and the like, or any such property or rights.

Without in any particular limiting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue stock and bonds and other obligations in payment for property purchased or acquired by it, or for any other object in or about its business; to mortgage or pledge any stock, bonds or other obligations, or any property which may be ac-

quired by it, to secure any bonds or other obligations by it issued or incurred; to guarantee any dividends or bonds or contracts or other obligations; to make and perform contracts of any kind and description; and in carrying on its business, or for the purpose of attaining or furthering any of its objects, to do any and all other acts and things, and to exercise any and all other powers not inconsistent with the laws of the State of ——— or of the United States.

REAL ESTATE.

The objects and purposes for which this corporation is formed are and shall be to carry on and conduct a general real estate business; to acquire by purchase or otherwise, and to hold, sell, lease, mortgage, improve or rent both improved and unimproved real estate, and to plat, survey, subdivide and lay out the same into townsites, blocks or lots or other subdivisions thereof, and to acquire by purchase or otherwise, and construct, build, own, hold, lease, mortgage and convey houses and buildings of every kind and nature whatsoever; to acquire, bond, own, hold, lease, mortgage, sell and convey real and personal property of any kind and nature; to buy, own, acquire sell, lease, convey, mortgage, and hypothecate real estate and personal property of every kind and nature whatsoever; to loan money and take security therefor, and to raise and borrow money by means of notes, bonds, debentures, mortgages or other evidence of indebtedness; to purchase property, stock or bonds of other corporations engaged in any or all of the objects and purposes above mentioned, and to issue and use stock, bonds or other obligations in payment for such property, stock, or bonds, and to issue and use stock, bonds or other obligations of the corporation for any object

or purpose in connection with any of its business, engagements, or the promotion of its affairs, and to do any and all things necessary, proper or convenient to carry out any of the objects and purposes of the company conformable to the laws of the United States and to the laws of the State of ———.

NOTICE OF ASSESSMENT.

(Name of corporation in full. Location of principal place of business.) Notice is hereby given, that at a meeting of the directors, held on the (date), an assessment of (amount) per share was levied upon the capital stock of the corporation, payable (when, to whom, and where). Any stock upon which this assessment shall remain unpaid on the (day fixed) will be delinquent and advertised for sale at public auction, and, unless payment is made before, will be sold on the (day appointed), to pay the delinquent assessment, together with costs of advertising and expenses of sale.

(Signature of secretary, with location of office.)

DELINQUENT NOTICE

(Name in full. Location of principal place of business.)

Notice.—There is delinquent upon the following described stock, on account of assessment levied on the (date), (and assessments levied previous thereto, if any), the several amounts set opposite the names of the respective shareholders, as follows: (Names, number of certificate, number of shares, amount.) And in accordance with law (and an order of the board of directors, made on the (date), if any such order shall have been made), so many shares of each parcel of such stock as may be necessary, will be sold, at the (particular place), on the (date), at (the hour) of such day, to pay delinquent assessments thereon, to-

gether with costs of advertising and expenses of the sale.

(Name of secretary, with location of office.)

UNITED STATES INTERNAL REVENUE.
RETURN OF ANNUAL NET INCOME.

MANUFACTURING CORPORATIONS.

Return of Net Income Received During The Year Ending December 31, 191- by ——— a corporation, the principal place of business of which is located at (street and number) ——— ———, City or town of ———, in the State of ———.

1. Total amount of paid-up capital stock outstanding at close of year.....\$———
2. Total amount of bonded and other indebtedness outstanding at close of year... ——
3. GROSS INCOME (see Note A)..... ——

DEDUCTIONS.

4. Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation EXCLUSIVE OF INTEREST PAYMENTS (see Note B)..... ——
5. (a) Total amount of losses sustained Jan. 1 to December 31 not compensated by insurance or otherwise..... ——
- (b) Total amount of depreciation Jan. 1 to Dec. 31..... ——
6. Total amount of interest paid January 1 to Dec. 31 on an amount of bonded and other in-

debtedness not exceeding the
amount of paid-up capital stock
outstanding at the close of the
year

7. (a) Total taxes paid January 1
to December 31 imposed under
authority of the United States
or any State or Territory
thereof
(b) Foreign taxes paid.....
8. Amount received by way of divi-
dends upon stock of other cor-
porations, joint-stock compan-
ies, associations, and insurance
companies subject to this tax..
Total Deductions (see Note B)...\$
9. NET INCOME
10. Specific deduction from net income al-
lowed by law.....\$5,000.00
11. Amount on which tax at 1 per centum is
to be calculated for assessment.....\$

STATE OF _____, County of _____, To-wit:
_____, President, and _____, Treasurer of the _____
corporation, whose return of annual net income is set
forth above, being severally duly sworn, each for him-
self, deposes and says that the foregoing report and
the several items therein set forth are, to his best
knowledge and belief and from such information as he
has been able to obtain, true and correct in each and
every particular; that the amount of gross income
therein set forth is the full amount of gross income,
without any deduction whatsoever, received from all
sources by the said corporation during the year stated,
and that the net income therein set forth is the full

amount by which to measure the tax at 1 per centum for assessment.

President.

Treasurer.

SWORN AND SUBSCRIBED to before me this
— day of —, 191—.
Seal of Officer
taking Affidavit.

(Official capacity)

CERTIFICATE OF INCREASE OF CAPITAL STOCK.

A special meeting of the stockholders of the _____ a corporation organized and existing under and by virtue of the laws of the State of _____, was held at Room _____, Brown Block, in the City of _____, State of _____, being the principal place of business of the corporation, on the — day of —, 1912, at the hour of — o'clock, — M., in accordance with the resolution and order of the Board of Directors of said corporation, passed on the — day of —, 1912, calling a special meeting of the stockholders for this date.

The resolution and order together with the call and notice was regularly and as by law and the by-laws of the company required, addressed and mailed to each stockholder as hereinafter set forth.

On motion duly made, seconded and unanimously carried, J. R. Brown was selected as President of said meeting and presided, and on like motion N. C. Bardsley was selected as Secretary and acted as recording officer.

There was present in person, at the meeting, stockholders owning and holding _____ shares and _____ shares represented by proxies duly and regularly executed and filed with the company.

The entire capital stock of said corporation was, on said — day of —, 1912, — Dollars, divided into — shares of the par value of — Dollars each, and the total number of subscribed shares of said corporation was on said — day of —, 1912, and now is, — shares.

On motion duly made, seconded, and carried, the chairman caused the secretary to read the resolution of the board of directors calling said meeting of stockholders, which said resolution is in words and figures following:

Be it resolved and ordered that a meeting of the stockholders of the —, a corporation, be called for, and held on —, the — day of —, 191—, at — o'clock, in the — of that day, at room No. —, — Building, in the City of —, State of —, for the purpose of considering and acting upon a proposition to increase the capital stock of said corporation from — Dollars divided into — shares of the par value of — Dollars each, to — Dollars divided into — shares of the par value of — Dollars each.

That notice of said meeting be published in —, a newspaper published in said —, once a week for at least — days.

That the secretary of said corporation is hereby directed to address and mail a notice of said meeting to each of the stockholders of said corporation, in the manner prescribed by the by-laws of the company and the laws of this State at least — days before said day appointed for said meeting and that said notice be in the following form:

“NOTICE TO STOCKHOLDERS OF —.”

“Notice is hereby given that, in pursuance of a resolution and order of the board of directors of the —, a corporation organized and existing under

the laws of the State of ———, unanimously adopted at a regular meeting of said board, duly held on the ——— day of ———, at room No. ———, ——— Building, in the City of ———, in said State of ———, a meeting of the stockholders of said corporation is hereby called and will be held at the office of said corporation, at room No. ———, ——— Building, in the City of ———, State of ———, on ———, the ——— day of ———, 191—, at ——— o'clock in the ——— of that day, for the purpose of considering and acting upon the proposition to increase the capital stock of said corporation from ——— Dollars divided into ——— shares of the par value of ——— Dollars each, to ——— Dollars divided into ——— shares of the par value of ——— Dollars each.

“The amount to which it is proposed to increase the capital stock is ——— Dollars.

“By order of the board of directors.

“Dated ———.

“Secretary of ———.”

The secretary thereupon read the following affidavits of himself and ———, to wit:

AFFIDAVIT OF ———.

STATE OF ———, }
County of ———. } ss.

——— being duly sworn, deposes and says that he is, and at all the times hereinafter mentioned was, a male citizen of the United States and over the age of twenty-one years; that he is, and for more than a year continuously last past has been, secretary of ——— a corporation organized and existing under and by virtue of the laws of the State of ———; that on the ——— day of ———, he addressed to each of the

stockholders of said corporation whose names appear on the books of said company as sufficiently addressed, at his place of residence (the place of residence of each of said stockholders then and now being known to affiant) a notice of which the following is a true copy: (Here insert copy of newspaper notice.) And that on said — day of —, 191—, he deposited in the United States post office in —, County of —, State of —, with postage fully prepaid, each and all of said notices addressed as aforesaid; that the stockholders to whom said notices were addressed and mailed as aforesaid, were, on said — day of —, 191— and now are all the stockholders of said corporation.

Subscribed and sworn to before me,
this — day of — A. D. 191—.

(seal) Notary Public in and for
the County of —
State of —.

AFFIDAVIT OF —.

STATE OF —, }
County of —. } ss.

—, of —, having been first duly sworn, deposes and says; That he is a citizen of the United States; that he is, and at all the times hereinafter mentioned was, over twenty-one years of age and competent to be a witness on the hearing of the matters mentioned in the printed notice hereinafter set forth; that he has no interest whatsoever in the same; that he is the principal clerk of the printers and publishers of —, a newspaper printed and published daily (Sundays and legal holidays excepted) in —, State of —, and has charge of all the ad-

vertisements and notices to stockholders of ———, of which the following is a printed copy (here insert printed copy of notice); that the notice hereto attached (here attach copy of newspaper notice) was published in the above-named newspaper (Sundays and legal holidays excepted) for a period of once a week for at least ——— days and once a week for ——— months, on the following dates, to wit: ———.

Subscribed and sworn to
before me, this — day of ———
A. D. 19—.

Notary Public in and for
(seal) the County of ———,
State of ———.

Thereupon, upon motion duly made, seconded and carried, it was by the meeting

RESOLVED, that notice of this meeting has been given in accordance with the requirements of the laws of the State of ——— and that more than ——— of all the capital stock of this corporation is at this meeting represented and the owners thereof present, and that this meeting is competent to proceed with the transaction of the business for which it has been called.

Thereupon, a motion was duly made, and seconded that the following resolution be adopted, to wit:

RESOLVED by the stockholders of ——— representing more than ——— of all the subscribed capital stock of said corporation, in meeting duly assembled and called by the board of directors of said corporation, that said corporation, increase its capital stock from ——— dollars divided into ——— shares of the par value of ——— dollars each, to ——— dollars divided into ——— shares of the par value of ——— dollars each, and that the said capital stock of ——— dollars be and the same is hereby increased to ———

dollars divided into ——— shares of the par value of ——— dollars each; that the chairman and secretary of this stockholders' meeting and a majority of the directors of said corporation sign the certificate required by law, and that said secretary file the same in the office of the county ——— of the county of ———, State of ———, and file a certified copy thereof in the office of the secretary of state of said state.

Upon being put to vote, said motion was unanimously carried, and said resolution adopted, by a vote of ——— the stockholders of said corporation, said stockholders owning and representing ——— capital stock. The chairman thereupon declared the result of said vote as above stated and there being no further business to be transacted, the meeting, on motion duly made, seconded and carried, adjourned.

————, Chairman.

————, Secretary.

We, the undersigned, ——— ———, chairman, and ——— ———, secretary, of the aforesaid special meeting of the stockholders of the ———, a corporation organized and existing under and by virtue of the laws of the State of ———, and ——— being ——— board of directors of said corporation, do hereby certify that all the foregoing is true and correct and is a true and full record of the proceedings had and business done at said meeting of stockholders; and we further certify that the board of directors of said corporation, on the ——— day of ———, at a regular meeting of said board at which a majority of said board was present, unanimously passed and adopted the resolution set forth in the foregoing proceedings as having been adopted by

said board and that, in pursuance of said resolution and order of said board of directors, notice of said meeting of stockholders (which notice is hereinbefore set forth) was given by publication ——— a week for at least ——— days, in a newspaper published in the County where the principal place of business of said corporation is located, in the manner stated in the foregoing affidavit of ———; and that the secretary of said corporation also addressed a copy of said notice to each of its stockholders at his known place of residence, at least ——— days before the day appointed for said meeting of stockholders, in the manner stated in the foregoing affidavit of ———; that the originals of said affidavits of ——— ———, and ——— ———, are now on file in the office of the secretary of said corporation; that said meeting of stockholders was held at the time and place indicated in said notice; that said place of meeting was at the principal place of business of said corporation and at the building where the board of directors usually meet; that at said meeting there were present all the stockholders of said corporation, said stockholders owning and representing ——— subscribed capital stock, to-wit ——— shares; that the resolutions set out in the foregoing statement as being passed and adopted at said meeting of stockholders were duly adopted by an affirmative vote representing ——— subscribed capital stock of said corporation, to-wit: ——— shares; and that thereupon and thereby the capital stock of said corporation was increased from ——— dollars divided into ——— shares of the par value of ——— dollars each to ——— dollars divided into ——— shares of the par value of ——— dollars each.

IN WITNESS WHEREOF, we have hereunto set
our hands and seals this — day of —, 19—,

Chairman of said meeting of stockholders
(and President of said corporation).

(corporate
seal.)

Secretary of said meeting of stock-
holders (and of said corporation).

_____,
_____,
_____,
_____,
_____.

Being and constituting a majority of the
Board of Directors of said corporation.

STATE OF _____, }
County of _____. } ss.

On this — day of —, A. D. 19—, before me,
_____, a notary public in and for the county of
_____, State of _____, residing therein, duly commis-
sioned and sworn, personally appeared _____ known
to me to be the directors of the _____ the corporation
mentioned in the foregoing certificate of proceedings,
and to be and constitute _____ board of directors of
said _____; and they each duly and severally acknowl-
edged to me that they executed the foregoing instru-
ment as such directors respectively.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official seal the
day and year in this certificate last above
(seal.) written.

Notary Public in and for the county of
_____, State of _____.

STATE OF _____,
County of _____. ss.

On this ____ day of _____, A. D. 19—, before me,
_____, a notary public in and for the county of
_____, State of _____, residing therein, duly commis-
sioned and sworn, personally appeared _____,
known to me to be the president of _____, the corpora-
tion mentioned in the foregoing certificate, and
_____, known to me to be the secretary of said
corporation, and they each duly and severally acknowl-
edged to me that they have read the contents of the said
foregoing certificate and that the same are true of their
own knowledge.

_____,
President.

_____,
Secretary.

IN WITNESS WHEREOF, I have hereunto
set my hand and affixed my official seal the
day and year in this certificate last above
written.

(seal.)

_____,
Notary Public in and for the county of
_____, State of _____.

STOCK CERTIFICATE, PREFERRED.

No. ——— INCORPORATED UNDER THE LAWS
OF THE STATE OF ——— Shares ———.

THE AMALGAMATED TRACTION COMPANY.

Capitalization

2,000 Shares

Preferred 1,000

Common 1,000

Full Paid and Non-Assessable.

This Certifies That ——— is the owner of
——— Shares of the Preferred Stock of

AMALGAMATED TRACTION COMPANY

transferable only on the books of the Corporation by the holder hereof in person or by Attorney upon surrender of this Certificate properly endorsed. The holder of this certificate shall be entitled to receive, when and as declared from the surplus or net profits of the corporation, an annual dividend of seven (7) per cent. and no more, payable semi-annually on the dates fixed in the by-laws.

Dividends on the stock represented by this Certificate shall be cumulative, and shall be payable before any dividends on the common stock shall be paid or set apart, so that if in any year dividends amounting to seven per cent. shall not have been paid upon the stock represented by this Certificate, the deficiency shall be payable before any dividends shall be paid or set apart for the common stock.

In the event of liquidation or dissolution or winding up (whether voluntary or involuntary) of the corporation, the holder of this Certificate shall be entitled to be paid in full both the par amount of the shares herein represented, and the unpaid dividends accrued

therein, before any amount shall be paid to the holders of common stock.

The holders of preferred stock of this Company are not entitled to vote at stockholders meetings, nor shall said stockholders participate in the profits of the Company beyond the above mentioned provisional and cumulative dividends of seven (7) per cent. per annum.

The stock represented by this Certificate may be redeemed at the option of the Company at any time after 20 years from the date hereof, upon the payment of \$110 per share, together with all accumulated dividends.

IN WITNESS WHEREOF, the said Corporation has caused this Certificate to be signed by its duly authorized officers and to be sealed with the Seal of the Corporation at ———, ———, this — day of ———, A. D. 191—.

———, ———,
President.

———, ———,
Secretary.

Schedule of Incorporation Fees and Annual License For the Pacific States.

State	Capital Stock \$100, 000		Capital Stock \$250, 000		Capital Stock \$500, 000		Capital Stock \$1, 000, 000		Capital Stock \$1, 500, 000	
	Inc. Fee.	Ann. Lic.	Inc. Fee.	Ann. Lic.	Inc. Fee.	Ann. Lic.	Inc. Fee.	Ann. Lic.	Inc. Fee.	Ann. Lic.
Arizona.....	\$15. 00	None	\$15. 00	None	\$15. 00	None	\$15. 00	None	\$15. 00	None
California.....	60. 00	\$25. 00	75. 00	\$50. 00	75. 00	\$75. 00	100. 00	\$100. 00	160. 00	\$100. 00
Colorado.....	30. 00	2. 00	60. 00	5. 00	110. 00	10. 00	210. 00	20. 00	310. 00	30. 00
Idaho.....	40. 00	37. 50	60. 00	75. 00	60. 00	75. 00	100. 00	90. 00	150. 00	130. 00
Kansas.....	100. 00	None	175. 00	None	300. 00	None	550. 00	None	800. 00	None
Montana.....	50. 00	None	110. 00	None	185. 00	None	285. 00	None	335. 00	None
New Mexico.....	25. 00	None	25. 00	None	50. 00	None	100. 00	None	150. 00	None
Nevada.....	10. 00	None	25. 00	None	50. 00	None	100. 00	None	150. 00	None
Oregon.....	45. 00	50. 00	45. 00	70. 00	60. 00	100. 00	75. 00	125. 00	150. 00	175. 00
South Dakota.....	15. 00	None	20. 00	None	20. 00	None	30. 00	None	40. 00	None
Utah.....	25. 00	25. 00	62. 50	50. 00	125. 00	50. 00	250. 00	50. 00	375. 00	50. 00
Washington.....	25. 00	15. 00	25. 00	15. 00	25. 00	15. 00	25. 00	15. 00	25. 00	15. 00
Wyoming.....	10. 00	None	17. 50	None	30. 00	None	55. 00	None	80. 00	None

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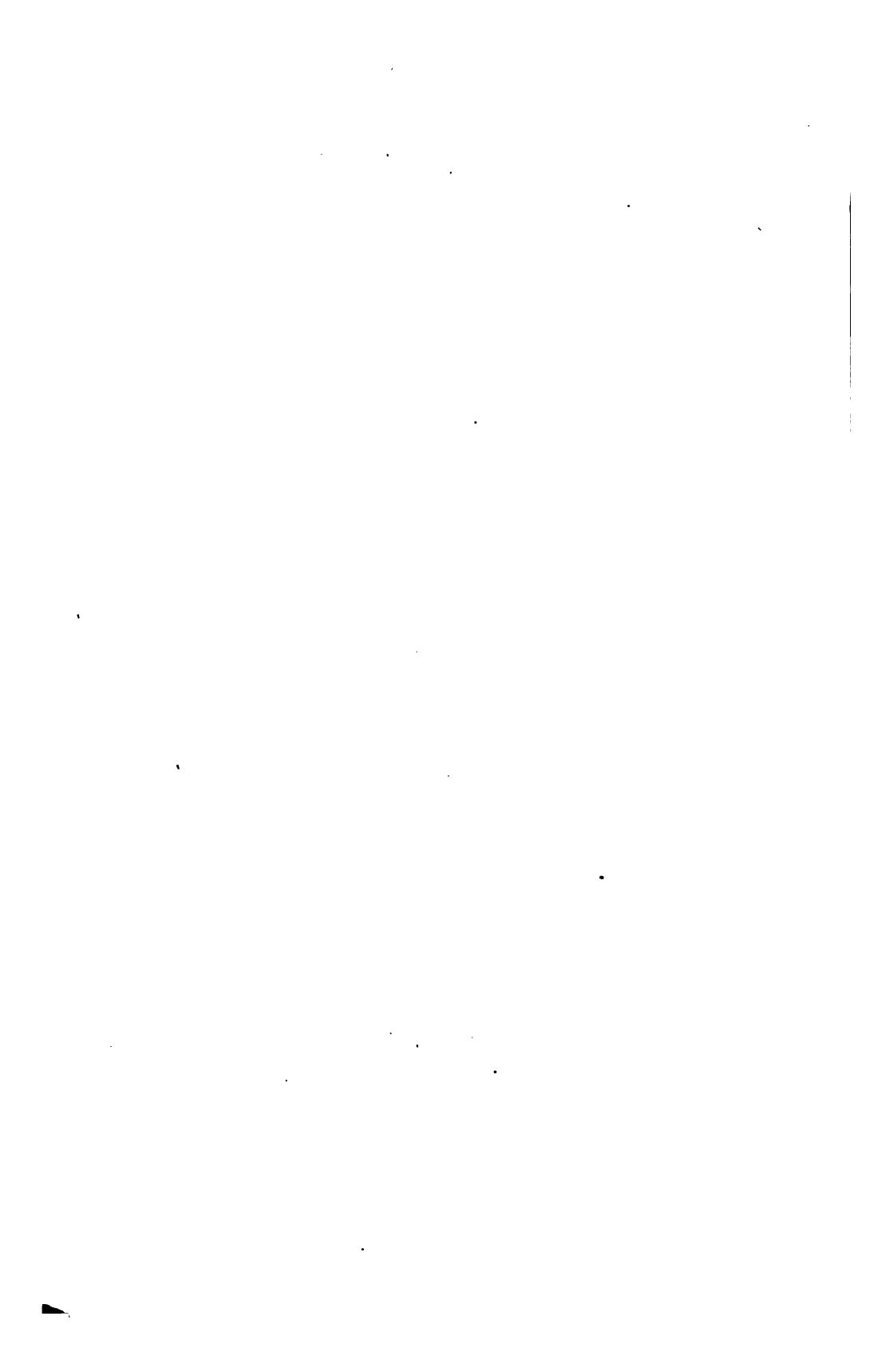
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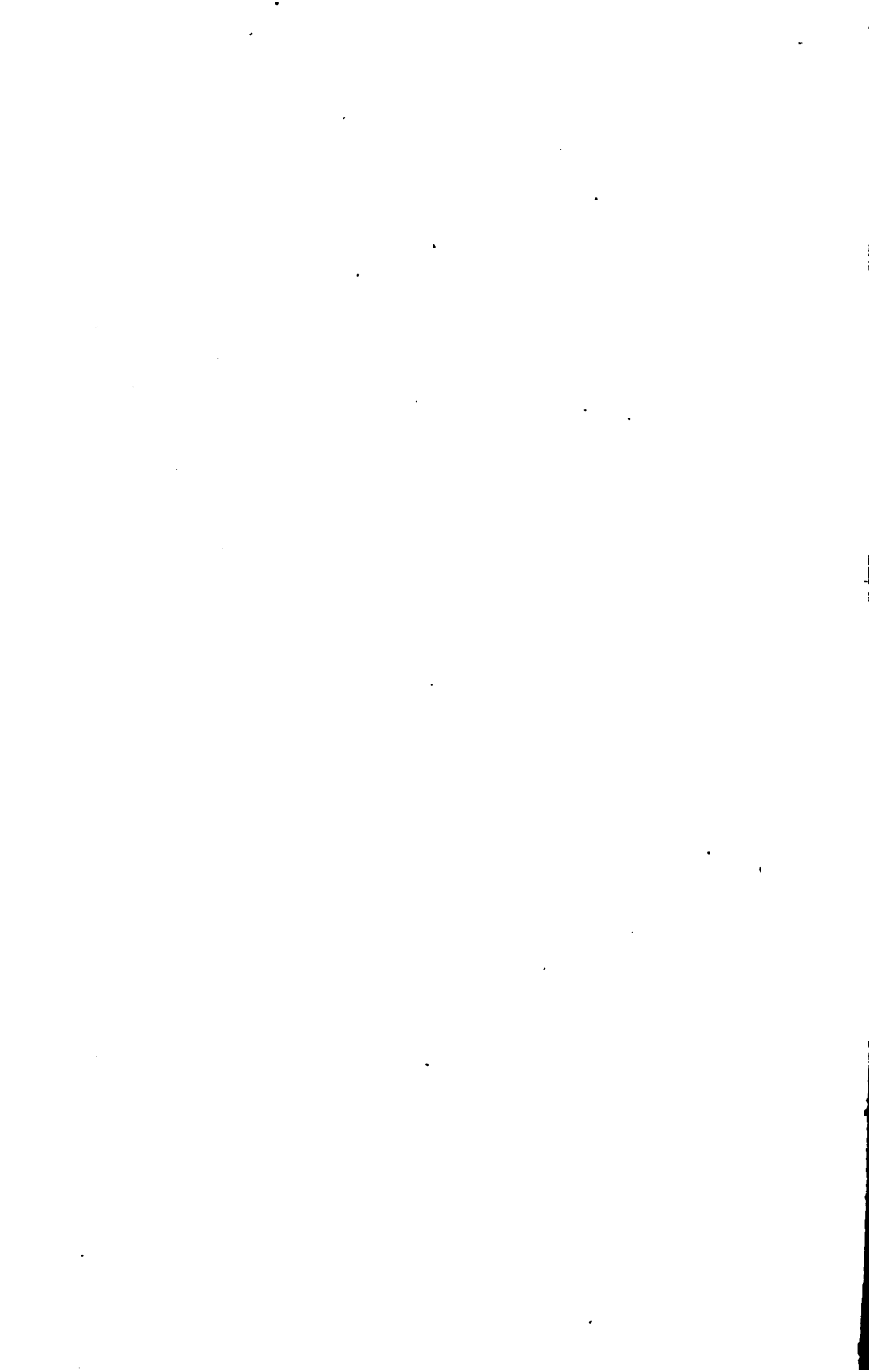
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